

In search of new horizons for the development of water supply system in Armenia



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For the last decade the progress of reforms in water supply systems management, the legal regulation of service provision in water supply and sewerage system, relevant infrastructures, quite recent substantial investments under the auspices of the government, and the water resources of the country are tangible bedrocks for initiating a qualitatively new phase of development within the sector. In 2005-2007 the Armenian government ratified two laws: On the Fundamental Profusions of the National Water Policy, and On the National Water Programme of the Republic of Armenia. It adopted the minimal quality benchmarks for drinking water, and water supply/sewerage services, together with a number of other legal acts. Several state agencies were formed and keep operating in line with the legal regulatory framework. Their responsibilities are clearly distributed in most of the cases. In the result of gradual and consistent improvement of the quality of service provision, increased effectiveness of water systems management practices, and implementation of a policy aimed at increasing the efficiency of public expenditures, the previously centralized water system has currently been largely decentralized, and new functional mechanisms of financial management have been introduced.

However, there are still a number of serious challenges in the management of water systems in the country. The factors that make it necessary, in times of economic crisis, to consider new models of financing the current expenditures in water supply and sewerage services provision, as well as the necessary capital expenditures in water systems, are as follows:

- depreciated infrastructures and subsequent huge wastage of drinking water;
- complete economic self-sustainability targets of the service providers;
- necessity of ensuring a targeted approach to current government subsidies, in parallel with the reducing scope of partial subsidies from the state budget for current expenditures of individual service providers;
- defined benchmarks for ensuring access to water supply and sewerage services, as well as securing the availability; and
- priorities of policies aimed at poverty reduction.

It is worthwhile to note that any alternatives to the current philosophy underlying the development of the system should take into account a number of general conditions.

First, any change to the status quo should be introduced to the general public. Furthermore, public participation should be ensured in the process of selecting and refining any possible model. This is a requirement ratified by law. Moreover, in case policy makers fail to ensure the trust and support of the society to each possible change within the system infrastructures, they will have to face a resistant public opinion, typical to transitional societies in the process of new policy implementation.

Second, one needs to remember that while selecting one or the other alternative for the development of water supply and sewerage systems, it is practically impossible to draw on one policy priority alone. Certainly doing so during the selection process and the subsequent juxtaposition of the models recommended, would facilitate both the efforts of developing and finalizing the model, and the process of providing evidence for a policy decision and its eventual ratification.

However, in practice there are a number of policy priorities and treating one as a mere factor to optimize the other may yield controversial results. For instance, such an approach may end up with recommending a solution that is financially effective, though politically quite challenging to implement. Another outcome might be prevention of social turmoil, at the expense of yielding insignificant results in terms of efficiency of public expenditures. The issue becomes even more challenging when the envisioned reforms are discussed in a mid and long timeframe, taking into account the long-term targets defined in the Fundamental Profusions of the National Water Policy and the National Water Programme.

In this regard, it is interesting to consider a recent policy analysis by the Advanced Social Technologies (AST) which looks at the efficiency of expenditures within the drinking water service provision projects. The study offers two policy alternatives, comparing the two, as well as juxtaposing the models with the current policy in the light of several factors, such as access to and availability of services for various social groups, targets of public expenditures in this sector and poverty reduction.



19 Sayat Nova
Yerevan 0001
Armenia

Tel.: +374 10 582638
Fax: +374 10 527082

mail@ichd.org
www.ichd.org

From the discussed scenarios and respective financial management models the gainful one will obviously be the one which (*ceteris paribus*, plus the consideration of political-economic feasibility) implies to raise service fees up to a level ensuring complete compensation for current expenditures. Meanwhile, it will ensure that poor households get compensations analogous to the increased tariffs, and that the government maintains the level of capital investments as an owner or co-owner of water supply service providing companies. Still, such a model will benefit only if the geographical, political-economic and social realities in Armenia are integrated into its development. In this case it will be less vulnerable in terms of **indirect consumption/cross** subsidization, to name just one aspect, whereas the advantages of the recommended alternative will become quite substantial and significantly more presentable to the consumers and the public in general.

Thus, because of tangible differences in the actual cost price of services in several regions of the country, the present cross subsidies for the universal tariff (and therefore for the service provider as well) are a tangible political and financial-economic factor. It weighs equally with the goal of more efficient targeting of state subsidies for the current expenditures in the water system (incidentally, targeting should be based on identification of various income groups) and with the need to improve redistribution of state budgetary resources allocated for provision of these services. What complicates the issue further is the fact that though one service provider charges the same tariff for water supply in various regions of Armenia, the quality of both services (e.g. the duration of water supply) and the drinking water may vary drastically, which seriously entangles the knot of cross subsidies. In such a situation, while attempting to define policies on subsidization from the state budget or compensation schemes for specific social groups through social benefits equivalent to the changes in tariffs, it seems reasonable to emphasize one criterion: ensuring the benchmarks for quality of water and water supply services. It should also be noted that the social trust towards the current system of social security (including proper targeting within the system and addressing minimal needs of the poor) is yet not sufficient for shaping a favorable public opinion towards the recommended changes.

While discussing alternative options for increasing expenditure efficiency, it is necessary to address the central role of the government in planning and making capital investments in water supply and sewerage systems, because in contrast to a number of other infrastructures, planning capital expenditures necessary for the development of the water supply system solely by a free enterprise is rather vulnerable in terms of topography. For instance, in contrast to the natural gas supply system where the cost of gas is significantly higher, than the cost of service provision within the scope of current expenditures, the current expenditures in the water supply system are almost exclusively conditioned by the cost of service provision, whereas the cost of water resources is rather small. In comparison with the ICT sector where competition seems to ensure a more dynamic logic of formulating service tariffs, of ensuring access and availability and developing infrastructures, consumers of the water supply system are actually deprived of a choice of a service provider, which naturally restricts the dynamics of developing relevant infrastructures through competition. Moreover, capital investments offered for drinking water supply infrastructures should be discussed in parallel with the necessary capital investments in irrigation systems for homesteads, with the goal of avoiding improper usage of drinking water, ensuring systemic efficiency and securing a lawful and accountable practice.

The second model analyzed in the AST study is vulnerable in terms of ensuring a further financing mechanism for the capital expenditures. For instance, including these expenditures in tariffs in a form of amortization expenses implies that the latter will be raised in future, thus significantly reducing the number of advantages of the discussed model both in mid and long terms.

Thus, the discussed scenarios provide a basis for outlining the factors that need to be taken into account when developing effective and feasible policy recommendations. Moreover, in the result of analyzing the suggested models, it became possible to introduce a new discussion thread on the model of tariffs differentiated on the basis of consumption volumes, in parallel with the necessary warrants for ensuring the minimum volumes of drinking water consumption, including the mechanisms of targeted benefits, subsidies from the state budget and the volume threshold guaranteed by a zero tariff. Detailed and comprehensive discussion of such a model may turn into an effective and feasible alternative for positively changing the status quo in the water supply system of the country.

The paper is elaborated based on the opinions passed by the participants of the discussion “ Strengthening Institutions to Improve Public Expenditure Accountability in Water Sector”, which took place on October 4, 2011. The roundtable discussion was attended by independent analysts, government officials, and representatives of the international organizations.

The round table was organized in cooperation with the Advanced Social Technologies” research NGO