

## The big sale in the water supply market

IRINA MOULECHKOVA, PHD

PLAMENKA MARKOVA, PHD



Water supply, electricity, health and transport services, sectors that were formerly state monopolies, have all been privatised. This report focuses on the privatisation of water, which has been characterised by non-transparency and ineffectiveness, higher rates and a lack of infrastructure improvements. The restructuring of the water supply sector has already had a negative impact on the social and economic status of the population, as higher prices have eroded real household income.

### Governmental water supply strategy

According to the water supply draft strategy for development, transformation and management, which will be adopted by the end of 2002 by the Ministry of Regional Development and Public Works, BGL 7.7 billion (approximately USD 3.85 billion) in private foreign investments is needed to improve the country's water supply. In addition to the private sector, other financial resources include the pre-accession EU funds and direct state investment. The concrete parameters of the sharing of the investments will be identified in the National Programme for Economic and Regional Development. The main problem is the inefficiency in the management of a water supply operated by 51 state and municipal companies (providing potable water and sanitation) and the enormous losses of transferred water due to antiquated infrastructure, about 90% of which needs to be modernised. The result is the high cost of potable water for consumers.

The World Bank has demanded a new strategy for the involvement of the private sector in water supply, which includes a concession, followed by the contracts for management and concrete services. The strategy for privatisation involves mixed forms of operation such as the plan for the private investor to build a property, use it for a certain period and subsequently transfer ownership of the asset to the State.<sup>1</sup> The government intends to implement the concession strategy in other big cities such as Khaskovo, Pernik, Kyustendil, Dimitrovgrad, Vidin, Montana, Vratza, etc. According to the government, the main advantage of the concession policy is the expected high amount of private investment and the possibility for the State or municipality to have control over the investors. Now, after the rejection of the scheme in Varna and Schoumen, whether or not the other cities will adopt this model is uncertain.

### The case of Sofia Water

The use of the water supply in Sofia was given by concession to the International Water Ltd., a foreign company, at the end of 1999. In 1998-1999, 20 foreign companies expressed a preliminary interest in operating the capital's water supply of potable water and sanitation plus repairing the existing infrastructure. On 6 October 1999, the winner of the bid in which four companies (among them Vivendi and the French company Lyonnaise des Eaux, which intended to bid for Varna and Schoumen as well but in consortium with Aqua Mundi) took part, International Water Ltd. (a consortium between US Bechtel Enterprise and British United Utilities International), signed a 25-year concession contract

with the municipality of Sofia. The Sofia Water Joint Stock Company was established with 75% of shares belonging to the International Water Ltd. and 25% to the Sofia municipality. In November 1999, experts from Raiffeisen Investment (an international consultants' group) warned that International Water Ltd. would probably be incapable of investing in Sofia Water due to the lack of demand for the company's shares in the international finance markets and uncertainty about company's financial status and investing capacity.

### Poor performance, higher bills and a lack of new infrastructure

It quickly became evident that International Water Ltd. was incapable of fulfilling its contractual obligations. In July 2002, the municipality of Sofia accused International Water of both contract violations and poor performance. Most consumers have been forced to pay disproportionately high water bills in advance due to the mistakenly reported high quantities of consumed water that have not actually been consumed.<sup>2</sup> The media publicized the case of an elderly, retired woman living in a flat who got a water bill as if she had an Olympic swimming pool. The concessionaire attributed the excessive charges to a new software system.

The present rates (for citizens and companies) of the potable water are very high under the excuse that the water supply utilities are very old and need modernisation. The Sofia Water company is also accused of ignoring complaints by consumers such as delayed reaction to emergencies (for example, a failure in the central water-supply network and the subsequent flooding of streets, basements, etc.); random stoppages in water supply to homes and districts; and chaos in servicing consumers. The transparency promised by the British company vanished. Moreover, the Sofia municipality has indirectly sided with the British investor against the interests of the taxpayers by not fulfilling its rights for control as a member of the joint stock company, Sofia Water. Other complaints against the new company, such as non-compliance of the new infrastructure, namely the new water-meters, with the current standards and low water pressure on high floors, are currently under discussion.

Because of poor performance, the municipality threatened to cancel the contract with the foreign investor. However, no concrete steps were taken. In the meantime, other scandals took place, such as the appointment of sub-contractors to maintain infrastructure. According to legal experts, the procedure for the selection and appointment of the four firms' sub-contractors also violated the contract.

<sup>1</sup> Concession contracts last up to 35 years. The first one for 25 years was for Sofia, the capital of the country. Upon the advice of the World Bank and EU consultants, such contracts were planned for Varna (the sea «capital») and Shoumen (a city in the northeast part of the country) as pilot programs. However, after the recent failure of the concession scheme in Sofia, the municipal authorities in the both cities rejected the pilot project.

<sup>2</sup> Each month Sofia consumers pay USD 2.6 million for drinking water, 36% of which is lost due to dilapidated infrastructure, theft and non-registered companies. Every day 700,000 cubic meters of water are directed to water pipes in Sofia while consumers actually receive only 448,000 cubic meters.

### *Who is the owner?*

International Water Ltd. has sold its shares in the Sofia Water company, but the public does not know the new owner's identity, even though this investor controls the water supply of 1.3 million consumers. Although the mayor of Sofia claims that he has been unofficially informed about the sale, the new contract needs to be approved by the Municipality Council of Sofia and European Bank for Reconstruction and Development (EBRD), the latter being the financing institution of the concession contract. The National Committee on Water Supply announced that International Water Ltd. had not been registered in Great Britain. It was registered in the Netherlands to benefit from liberal taxation as a foreign company operating in a third country.

### *Where does the bill end?*

Although the provisions of the concession contract stipulated the preservation of the initial rates for the first three years, the price of water increased twice during the second year of the contract. Sofia Water also demanded an additional increase of 16-17% in October 2002 because of the urgent need to repair the Beli Izkar dam reservoir—one of the capital's main sources of potable water. The Sofia City Council did not approve the demand for the new price increase until the end of 2002. It argued that the rate of inflation is low and under control because Bulgaria is under the Monetary Board, and that the company has obligations under the contract to modernise the whole water supply infrastructure, including the dam reservoir as a part of the system.

Omonit, the regulatory agency, found out that the initial owners of Sofia Water reported spending USD 6.2 million, but the company could only present relevant documents for just USD 1.9 million. The investor justifies the expenditure with the high commission it had to pay to the EBRD and consultant fee to Price Waters Coopers consultants. There is no transparent information for what services the fee included.

The media revealed that EBRD gave Sofia Water a loan of EUR 35 million for the repair of water supply infrastructure and delivered EUR 15 million of that amount on 22 December 2000. From this amount EUR 13.5 million was transferred outside the country by United Utilities International and International Water Ltd. Relevant documentation was presented by independent experts in January 2001 to the Bulgarian parliamentarians from all political parties in the three Sofia electoral regions. Clearly, not only the municipality takes the side of the foreign investor (whomever it is now), but so does the State as a whole, including Parliament and the competent Ministry of Regional Development and Public Works, by ignoring the dubious fulfillment of the contract which undoubtedly affects the interests of water consumers and taxpayers.

The Sofia case is characterised not only by the illegal increase of water rates for the population, excessively high bills, and payment of non-consumed water, but also by the lack of a long term strategy for the repair of the water supply system. Reconstruction projects typically occur in case of emergencies, and thus the water may be cut at any time. Some reconstruction projects started in the summer of 2002, but they do not involve systematically the whole water infrastructure of the capital. Partial reconstruction of Beli Iskar dam reservoir was one of Sofia Water's justifications for the 16% increase in the water rates dating from 5 October 2002. On the other hand, in its bid for the contract the initial foreign investor promised BGL 81 million in investments for 2002 and BGL 340 million for the next 15 years. The winner proposed the highest price for the concession rights and the highest amount of the offered investments. All these parameters were included as main provisions in the concession contract.

### **The big sale**

The privatisation of the water supply firms in the other locations also resulted in non-transparency and ineffectiveness at repairing old infrastructure. With the amendments of the water laws, the infrastructure—the network of pipes, pump stations and purifying stations—will be withdrawn from the companies' assets as state or municipal property under different legal forms. The use of such assets will then come under the control of the private investors. The process will start in 2003, as by the end of 2002 the law for the national regulation of the sector will be in effect. A new agency that will supervise the quality and the level of the service as well as the price of the water will be in place starting in 2004.

Consequently, the big sale of the sector will begin in 2003. The selected concessionaire will have the right to manage the water supply for up to 35 years from entering into a contract, the terms of which could be prolonged by the mutual consent of the parties based on the decision of the Council of Ministers (the governing body according to art. 6 of the Law on Concessions) but for no more than 50 years (art. 3 of the Law on Concessions). In exchange, a certain amount of investment is required. For example, for the failed scheme in Varna and Shoumen, the minimum amount announced was USD 108-110 million. In this case, in order to avoid the scandals that plagued Sofia Water, the law is expected to regulate and control the investments and the performance of the contract. However, it should be stressed that the process of privatisation and liberalisation of the water supply market is influenced by highly paid foreign consultants promoting the interests of the potential foreign investors and themselves at the expense of the taxpayers.

### **The rights affected**

The right to an adequate standard of living as agreed upon in the United Nations Millennium Development Goals Declaration means that States have to ensure that all trade agreements under WTO auspices, as well as the process of privatisation and liberalisation of basic public services, will not jeopardise the social and economic condition of their citizens, their fundamental rights to life and development, as stated in art. 8 (1) of the UN Declaration on the Right to Development.

The International Financial Institutions continue to insist on marketing services previously in the public and non-commercial realm, arguing that investments in these areas will have a major effect on growth and poverty reduction and that they need to increase dramatically by attracting new sources of finance. However, it is clear that privatisation and liberalisation of the basic public services without any protective measures from the State could result in impoverishment of the population as a whole and violation of the right to life, the right to an adequate standard of living and the right to development. Any similar policy would deprive citizens of their right to economic and social protection from the State. The restructuring of the water supply sector in Bulgaria has already had a negative impact on the social and economic status of the population, as higher prices have eroded real household income.

### **Recommendations**

The Bulgarian government has to take all possible measures to minimise the negative effects of the privatisation and liberalisation of basic services through including parameters for the protection of the social and economic rights of citizens and their social security status in the negotiation process with the WTO, IMF and EU. The State has to comply with all previous international obligations arising from international agreements to which Bulgaria is already a party, including the International Covenant on Economic, Social and Cultural Rights.

Bulgaria should include viable mechanisms for the control and supervision of private domestic and foreign investors in the service sectors in its domestic legislation before further service liberalisation proceeds.

The State has to undertake adequate legislative and other measures to avoid and limit corruption among state and municipal bodies in the process of liberalisation of the trade in services that is imposed externally. ■

### **Bibliography**

- Press information from newspapers «Capital», «Monitor», «Trud» and «Banker».
- Report of the Protecting Consumers Association on Water Concession.
- «Water and Poverty», remarks by J. Saghir, Director Energy and Water. The WB at the opening of the Water, Health and Poverty Day, WaterDome, 2 September 2002 in WSSD, Johannesburg.
- Ariel Dinar and Ashok Subramanian, Editors. «Water Pricing Experiences: an International Perspective». WB Technical Paper 386, 31 October 1997.
- Paul Holden and Mateen Thobani. «Tradable Water Rights: a Property Rights Approach to Resolving Water Shortages and Promoting Investment». Policy Research Working Paper 1627, 31 July 1996.