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Water Privatization in Russia: More Than a Drop in the Ocean

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Without water, humans can only live for a few days. Yet only about 1 percent of the earth's water is suitable for human consumption. Rising GDP brings increases in demand for food production, including meat, which demands the greatest amount of water. Treating water is therefore a key utility. With over $400 billion in annual turnover, freshwater supply and wastewater treatment account for over a third of the global utilities market. The global water supply sector holds great potential for growth but requires continuous, massive infrastructure investment.

Many governments throughout the world face various issues to keep up with these efforts. Resource-constrained, many resort to various private sector solutions such as outright privatization of water-supply companies, public-private partnerships or other arrangements involving private partners. In Europe, in particular, various trends are noticeable in the water-supply sector. Acea, a private Italian company that has a virtual monopoly over Rome's water supply, expanded into Yerevan, Armenia, to serve its 1 million inhabitants. EVN,

an Austrian water and energy utility provider of Lower Austria's provincial government, moved to consolidate part of the water supply in Austria with their purchase of WTE Wassertechnik from German company Berlinwasser.

In Russia, approaches vary greatly as local and regional governments face urgent need for modernization of outdated infrastructure and failing facilities, neglected for decades under Soviet management. The largest and most notable of Russian water utility companies is surely Mosvodokanal (MVK), Moscow's water supplier, which serves over 13 million of the region's residents (accounting for around 10 percent of the total population of the country). As the largest water company in Russia, MVK dominates the water-supply market of the capital and, as many other large water utility companies in Russia, it faces challenges as the need to invest in modernization of neglected facilities and Soviet-era infrastructure arises.

MVK and its owner, Moscow's city government, face significant financial pressures. As a state-owned company, MVK is affected by general investor prejudice toward the sector due to a lack of transparency and corruption. This puts MVK and the city government in an unfavorable position as they try to tap into financial sources for new and necessary investments. Furthermore, its finances are constrained. The city government wants to keep water tariffs low as the social gap widens. Many citizens on the verge of poverty would be severely affected by even the slightest price increases in basic services such as access to water. The tariffs in Moscow are among the lowest in Eastern Europe; many cities in Russia charge more for water. All of these circumstances contribute to a situation of insufficient financing for ageing infrastructure that can, with time, affect the quality and reliability of water supply and disposal, and public health. To ensure quality and reliability, MVK and its owners are forced to consider different sources of financing such as public-private partnerships or privatization.

The sale of Rosvodokanal, the oldest Russian municipal utility that supplies water to 10 Russian regions from Moscow to Vladivostok, might hold some lessons for decision makers. Rosvodokanal was sold to Alfa Eco, a notable division of Mikhail Fridman's Alfa Group that is recently in the news because of the sale of its stake in TNK-BP to Rosneft. Under Alfa Eco, Rosvodokanal's subsidiaries reduced their debt levels, increased revenue and tariff payments and decreased water loss from almost a third to just over a fifth of total water supplied. Importantly, through Alfa Eco Rosvodokanal tapped international financial resources such as loans from the European Bank for Reconstruction and Development and investments from Deutsche Bank, allowing for extended investments in infrastructure for its 5 million users nationwide. However, Rosvodokanal's revenue is not as constrained by low tariff's (among cities it serves is Rostov-on-Don with tariffs at the same level as those in Stockholm and Rome) and serves many fewer users.

The water privatization efforts of the early 2000s turned public opinion largely against private-sector participation in utility companies. This complicates any efforts to involve investors in MVK, although its privatization was announced several times in the past decade and then put back. After 2005, privatization of water utility companies like Rosvodokanal turned public opinion against private-sector participation in communal reforms. Political protests by activists and the wider public led to the postponement of announced communal reforms that included Mosvodokanal, as well as Nizhny Novgorod's and Vladivostok's water

utility companies.

Public-Private Partnerships (PPPs) might also be an effective solution, and MVK management has some experience in this field. Over the past decade, MVK entered into several PPPs with total investments exceeding $700 million. PPP investments in individual water supply or disposal utilities were part of the effort to decentralize the system's supply centers. PPPs are an opportunity for investors seeking low-risk investment opportunities as the water utilities sector offers steady growth and long-term returns. Management under private partners also usually brings increased efficiency and transparency. However, PPPs have their deficiencies — the extended period they need for project development and finding partners, the state's limited capacity for capital-intensive projects and the limited experience of financial markets with PPPs — which make them a complicated solution to an already complex issue.

Commenting on Moscow's plans regarding privatization, Deputy Mayor Natalya Sergunina underlined that MVK was not an asset that the city government was considering selling in the short term but rather one that it wants to develop in cooperation with private investors. Sergunina explained that MVK is a strategic asset and a "socially significant business" that the city government intends to maintain control of while offering private investors a minority stake. Through a minority private partner, MVK would primarily gain outside investment as well as better access to financial sources. Furthermore, as Sergunina recognizes, a private investor would also benefit MVK through independent management and increased oversight — an important benefit for majority publicly owned companies prone to a lack of transparency. Privatization via share issues has proven to be a beneficial strategy that can provide an additional level of oversight to strategic assets in which the state wishes to remain the dominant partner. Such a strategy is also planned in Lithuania, a leader in Eastern Europe in terms of state-owned-enterprise management.

MVK's owners have already taken steps toward increasing transparency, investing in modernization and transforming MVK into an attractive asset for eventual share-issue privatization. An efficiency rating published by Interfax last year evaluated the 100 largest Russian companies in terms of eco-energy efficiency, technological efficiency and transparency, and MVK emerged as a leader. Lately, MVK stepped up its public relations efforts with a regularly updated Twitter account and a call center with "water specialists" for users (8-495-7814709). Furthermore, a merger between MVK and Mosgaz was announced in October, indicating an intention to consolidate the city's utility companies in one entity before eventual privatization.

However, the need for investment to modernize water-supply and disposal infrastructure is great. Boris Gryzlov, former speaker of the State Duma, estimated that the Clean Water program for the modernization of water utilities would require over 15 trillion rubles ($450 billion) in investment. The Clean Water program is, to date, largely underfunded when compared with these estimates. For this reason, the local and federal government will likely consider involving private-sector partners in their plans.

With the strategic, limited privatization process that is at this moment planned for MVK, water utility companies in Russia would benefit from investment that could be directed toward modernization as well as better access to financing sources, increased transparency

and efficiency. At the same time, limited stock privatization would keep local governments in control of their assets, counter the public backlash against privatization and lessen the burden on the already stretched budgets of the federal and local governments during the financial crisis. The announced MVK privatization plan, if followed through, offers a model that Russian authorities should consider nationwide.

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