

Chapter VIII

UTILITY SERVICES

Introduction

Tariffs⁶⁰ for housing-related services are one of the most widely discussed topics in the Russian Federation today. TV talk shows as well as professional newspapers and journals highlight the different aspects of the new tariff policy and the problems related to it. The main concern is that all residents have to start paying the full cost of the services provided - the principle objective of the national housing reform. Residents, however, fail to understand why tariffs for housing and municipal services (ЖИЛИЩНО-КОММУНАЛЬНЫЕ УСЛУГИ) continue to increase when roofs and pipes still leak, and the municipal management companies cannot repay their debts to the utility providers.

Although the concept of full cost recovery seems normal – the consumer of a service should pay for the service provided – the problem in the Russian Federation today is much more complicated. Housing and community are inevitably handled as one interrelated ‘housing and municipal complex.’ The companies of this complex provide ‘housing and municipal services’, including running the housing stock, maintaining and repairing it, but also utility services and rubbish collection. Today its major problems are related to its inherent contradictions:

(a) According to official statistics, the average resident has a reasonable amount of housing space at his disposal; and most urban apartments are equipped with the necessary amenities (central heating, piped water, electricity, etc.). However, the housing stock and the utility infrastructure are in very poor condition and during the past 15 years no adequate funding has been made available to maintain these amenities. So there is a considerable imbalance between the standard of services provided and the prices/tariffs that households are charged. Consumers do not receive value for money.

(b) Household income is low and neither the households nor the public budgets can afford the prices of the services provided. Continuously

increasing the tariffs will cause a serious crisis both for the providers and for the consumers.

The term “crisis” is now officially used to describe this situation. Professional papers and policy documents list the following priorities to overcome it:

(a) Securing financial stability for the companies providing housing and municipal services;

(b) Establishing market-based instruments for housing and municipal services;

(c) Creating the right conditions to attract investment into these services to ensure their long-term operation;

(d) Encouraging households to take an active part in the management of the housing stock.

A. Technical condition of utilities

‘Community catastrophe’ – was a common headline during the winter of 2003 in the official Gosstroy newspaper ‘Stroytel'naja gazeta’ (Construction Newspaper). Already in 2002 there had been about 300,000 cases of heating pipes breaking. After the catastrophe of the 2003 winter, the following data were published about the condition of boiler houses. In the autumn of 2002, about 70,000 boiler houses were inspected, but only 76% of these were certified as ready for the heating season. Thus, during the extremely severe winter of 2003, there were 86 major emergencies, with dwellings cut off from heating for more than 36 hours in 38 regions of the Russian Federation. According to the press, in January 2003 heating provision was disrupted in 4,000 apartment blocks, affecting 350,000 residents.

The situation is similar with regard to the water supply. In more than 100 big cities the water supply to residential areas is irregular. On average, in the Russian Federation, 25% of the water supply is lost in the pipes and more than 40% does not meet health requirements. The deficit of water pipeline capacity exceeds 10 million m³.

⁶⁰ Tariff: the target price for a service set by the relevant public authority.

According to data of Gostroy, the rate of physical wear-out of the water-supply networks is 54.2%, of heat-supply networks 56.7%, for electricity supply 68%, and engineering communications in general 60%. About 7% of the district heating networks and 16% of water pipelines need urgent modernization. The accumulated losses within the heating networks, including those caused by the worn-out state of the pipes, equals 30% of the produced heat, which would represent 58–65million tons of fuel a year.

The annual number of accidents per 100 km of engineering communications has increased from 15–20 in the mid-1990s to 70 for water and sewerage networks and to 200 for heat-supply networks in 2000. The European average is three.

In the cities only 30% of sewers are cleaned by municipal sewerage systems to satisfy the norms. The capacity shortage of sewer systems is 9 million m³ per day (16.5%), about 17% of the networks require major repair; but practically no money is earmarked for these purposes.

From 40 to 80% of the resources of local budgets and a substantial part of the budgets of the “subjects of the Russian Federation” are allocated to housing and municipal services. New housing construction brings losses to cities as every new residential or social building requires additional inputs, deepening the budget crisis.

The following facts further demonstrate the technical situation in the sector:

(a) Between 50 and 60% of the heating and sewage pipes require major repair, the remainder needs to be replaced altogether; 29,000 km of pipes are said to be in a critical situation;

(b) The actual losses of thermal energy and water in the pipelines in some regions are said to be about 55-60%, compared to the normative level of 16%, which is considered to be ‘reasonable’;

(c) The housing stock requires major repair. While the average norm for major repairs is

between 4-6% of the existing stock annually, in reality in some regions in 2002 major repair was carried out only on 0.1% of the stock.

Today not only the professionals but also the politicians on all the levels of government speak about the threat inadequate infrastructure poses to Russian cities and human settlements. The former Prime Minister, Mr. Kasyanov, speaking in the Duma in early spring 2003, analysed the critical break-down in utilities and housing during the winter of 2003 as follows:

(a) One third was the result of major obsolescence, lack of repair and poor preparations;

(b) Another third was due to the non-professional operation of the equipment, i.e. there is lack of professionalism in the sector; and

(c) Finally, the remainder was due to extremely bad weather.

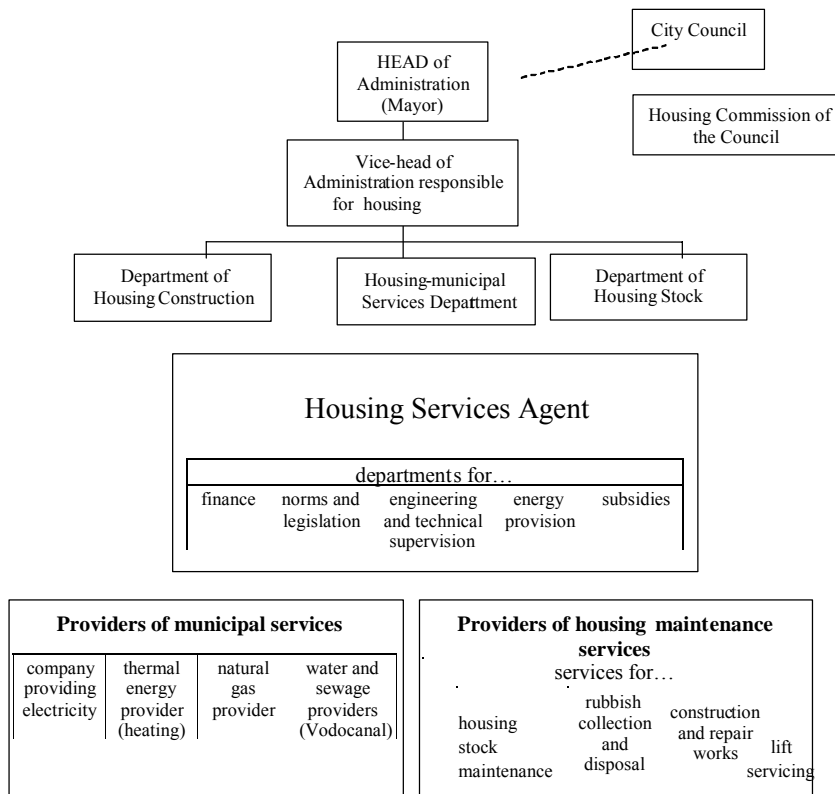
B. The system of management

As described in part one, chapter III, municipalities are still seen as the owners of the dwellings and the municipal companies continue to provide most of the services. There are about 52,000 companies of different ownership with more than 4.5 million staff to provide housing and municipal services, i.e. about 600 m² of housing stock per employee. Yet, it is quite difficult to get clear data on how the staff is placed and what the responsibilities are.

The services are generally provided through municipal enterprises for maintenance, heating, water, etc. There are only a few cases where this function is exercised by privately owned management companies. Private management and maintenance companies are said to number fewer than 200. Private companies are more active in providing different maintenance work and repair, but also rubbish disposal services.

The management and maintenance of housing estates is arranged according to jurisdictions, so the service companies have access only to administratively divided markets.

Figure V. Structure of housing and municipal



The current system of services gives rise to conflicts of interest. If a household cannot pay for all the services provided, the municipal authorities have to make up for this shortfall. In fact, the municipal authorities should try to reduce the costs of the services so that fewer budget funds will be required for such subsidies. The municipal authorities and relevant managerial structures should strive to reduce the tariffs.

However, the municipal authorities are also the owners of the service companies and they have to pay their staff. Any losses that these companies make are also losses for the municipal authorities and social problems among the staff of these companies are of concern to the municipal authorities too.

personally responsible for the efficiency of their activities and for the expenditures incurred. An audit of heat provision in one of the regions in spring 2003 showed that the municipal ‘heating dealers’ had increased the tariffs for energy 2.5-2.8 times. This is clear evidence that the management system for providing such services lacks any incentive to reduce costs.

Assessments published in professional journals estimate that reasonable management in the sector and an increase in professionalism would cut the cost of utility provision by about 15%. Currently the housing and utilities sector ranks second after construction as the sector with the highest turnover of labour, and data about Moscow have revealed that that about 50% of the posts in the technical maintenance companies are vacant.

C. Tariff setting

The official price level for housing service provision is termed 'economically fair tariff' (экономический обоснованный тариф). According to Gosstroy, the average is about 22-24 roubles/m² for all the housing and municipal

services. In fact, it is approximately 25% higher because of the increasing prices of energy. It is also important to keep in mind that the official tariffs cover only operating and maintenance costs and, in general, do not include depreciation of the housing stock and no funds for repair are collected.

The utility service prices are regulated by all three levels of government. Local governments set prices, tariffs and rates for the municipally provided services. Sub-federal (regional) governments control the delivery of gas, power, heat and water supply by other providers. Moreover, responsibility for setting electric power and (co-generated) heating prices is delegated to special regional power supply commissions. At the federal level, regulation of the housing and municipal services lies with the Federal Power Supply Commission and the State Anti-trust Committee.

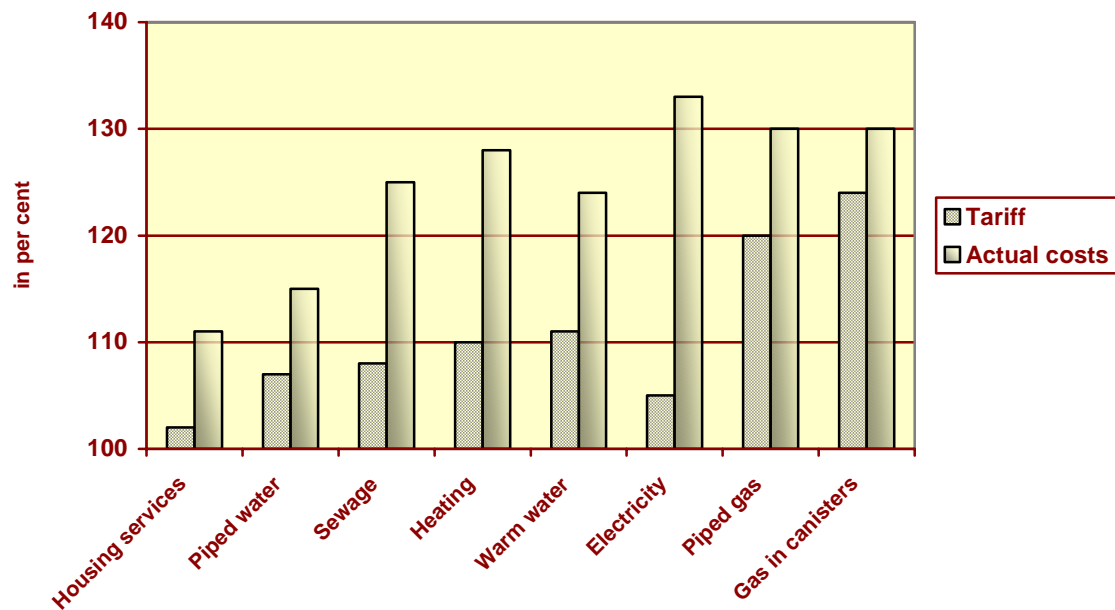
The tariffs for utilities (heating, water, sewage, but also natural gas) are normally calculated according to a standard system. The utility companies invoice the municipal managing company according to the existing norms of consumption or the actual amount of services provided (e.g. the amount of water pumped to the city) which are then multiplied by the economically fair tariff. The municipal management company divides this amount by the number of housing units in its jurisdiction and bills the consumer accordingly.

These schemes date from Soviet times. However, they are seriously flawed, especially because consumption by the final consumer (household) is

not accurate. In fact, except for electricity, there are no accurate figures as metering is very rare. Bills are largely based only on the total water or heat energy produced. They do not take into account whether the consumer has actually used the service, nor its quality.

The problem is aggravated by the fact that average consumption data (amounts) are used not only for invoicing of water, but also for calculating the norms of consumption. The national average is about 235 litres of water per resident per day; in 81 out of the 88 regions where data were available these norms were above 150 litres, with 389 litres in Moscow as the absolute maximum. However, the experience of homeowner associations in Moscow shows that it is easy to consume about 40% less than the norm when consumption is metered. So, the norms introduced for consumption are highly overestimated. If metering were more widespread, service provision would be more accountable and excess provision more difficult. For the seven regions where the norms for consumption were below 150 litres, or 27 litres as the absolute minimum, it can be argued that there is either no relevant service available, or the data provided are not fully reliable.

The main housing policy aim today, as mentioned above, is to raise all the tariffs for the services provided to households to cost-recovery levels. According to the comparative data in table xx of official tariffs and actual costs, during 2002 the costs to service providers increased more rapidly than tariffs. The official tariffs for the services that are set by the relevant authorities are much lower than the actual operating costs reported by the service providers.

Figure VI. Increase in tariffs and costs for services during 2002

Between 1993 and 2000 there were considerable increases in tariffs and the cost-recovery levels increased from 2-3% to 60-70% on average, not including charges for capital repairs. However, the Russian Federation still has the lowest level of cost recovery in Eastern Europe. Moreover, the service providers have come under increasing financial pressure because tariffs charged to consumers remain highly controlled, while price liberalization in other sectors has raised their costs.

In these circumstances, when tariffs are adjusted by different authorities either on the federal, regional or municipal levels, service providers have no incentive to lower the costs for utilities. If a service provider were to invest know-how and become more efficient at a relatively lower cost, the authorities would lower the tariffs accordingly. Higher operating costs on the other hand imply higher tariffs. Therefore the market is still producer-dependent and companies are interested in showing higher rather than lower operating costs.

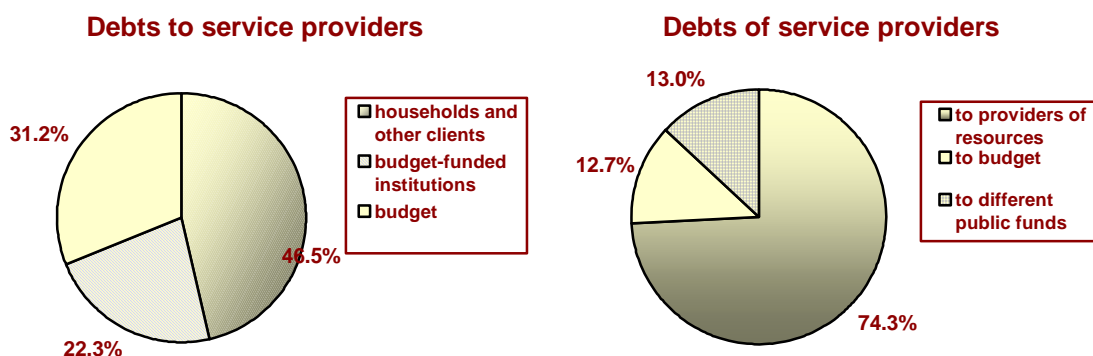
D. Affordability and payments

Utility bills often go unpaid and debts have mounted. In Moscow, on average, about 80% of

bills are paid on time, 10% are paid late and the remaining 10% are never paid. Currently, residents get bills showing the full costs of services, but they have to pay only about 60% (on average) of these costs. As incomes are too low to meet these costs in full, municipalities are expected to cover the remaining 40%.

Municipal budgets are usually small and housing accounts for about 40-60% of all municipal expenses. In Moscow housing services swallow about one third of the city's resources. As all the tariffs are constantly increasing, municipalities cannot fully compensate for the part that is not covered by households. Consequently municipal maintenance agencies do not have the funding to organize all necessary maintenance works and the municipal housing stock suffers from a lack of repair or/and maintenance. Every month the companies – especially the providers of utilities – are 2.3 billion roubles short: 0.5 billion due to unpaid household bills and the remaining 1.8 billion due to a shortage of funding from the budget.

Figure VII. Financial situation of housing and municipal service providers

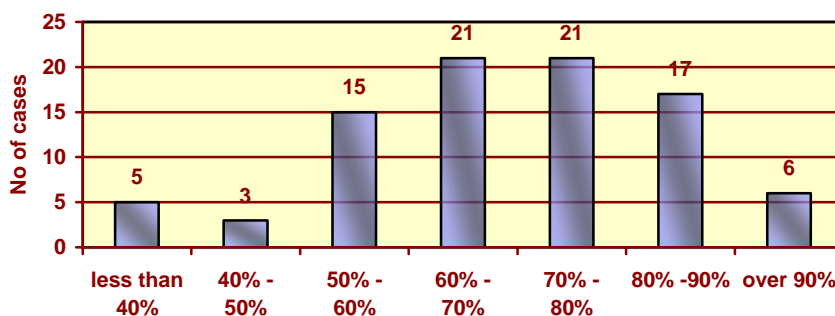


The charts above show the financial situation of the housing and municipal service at the end of 2002. In total, 184 billion roubles were owed to them for delivered but still unpaid services, the debt is 8.7% higher than the previous year. Roughly, half this debt is due by the households and by other clients, the other half is due by the budget. This shortfall in income means that the providers themselves owed 274 billion roubles to their creditors. In 2002, this sum increased by 7.8% compared to 2001.

According to the Gosstroy's monthly journal, the situation is likely to worsen substantially by the end of 2003. At best it will remain unchanged.

Based on data provided by Gosstroy for 2002, the average housing cost per resident was 465.76 roubles per month. However, on average residents paid only 322.01 roubles (69.14% of the sum due). The lowest cost per resident was 244.66 roubles and the highest 2593.28 roubles. This covered from 9.25% to 94.77% of the cost.

Figure VIII. Cost coverage by region



On the diagram above, data from the regions for 2002 are analysed to present the average cost covering percentages. The national average for the period was 69.14%. The histogram gives a clear picture of certain inter-regional problems of affordability. The vast majority of regions have a coverage percentage above 50%, but there are problematic regions in the far north and other

regions with severe climatic conditions where the cost coverage percentage is below 50%. Realizing this problem, Gosstroy has initiated a special national programme to resettle households from these regions.

Below is a randomly chosen bill for housing costs for June 2003 in a region where the average

housing cost per resident per month was 414.57 roubles (for 2002) and cost coverage was 56.38%.

In this apartment the household consists of two persons and the floor space is 35.7 m².

Table 15. Randomly chosen bill for housing costs for June 2003
(in roubles)

| Item | Rate per unit of measurement | Costs incurred |
|---------------------------|------------------------------|----------------|
| Technical maintenance | 0.51 | 18.21 |
| Cleaning the stairwell | 0.24 | 8.57 |
| Cleaning the surroundings | 0.73 | 26.06 |
| Major repair | 2.56 | 91.39 |
| Rubbish collection | 11.05 | 22.10 |
| Cold water | 78.05 | 156.12 |
| Hot water | 65.43 | 130.86 |
| Heating | 4.04 | 144.23 |
| Gas | 9.30 | 18.60 |
| Radio | 14.00 | 14.00 |
| TV aerial | 36.00 | 36.00 |
| Total | | 666.14 |

From a total bill of 666.14 roubles the household had to pay only 167.77 roubles, so 498.37 roubles were subsidized from different sources. The household's share is only 26.69%. The bill does not include electricity charges.

In early 2002, Moscow's Mayor Yuriy Luzhkov started a 'pilot project'. He called on people with incomes above R 8500 (\$280) per household member per month to pay 100% of housing costs on a voluntary basis. Thousands of families received two bills: a 'voluntary' (full price) bill and a normal bill (about 60% of the full price). Families could choose to pay either of the bills. Only 44 families paid the voluntary bill in January 2002.

E. Government initiatives

To address the problems of the housing and municipal services, the Federal Government initiated, on 17 November 2001, the housing reform sub-programme 'Reform and Upgrading of

the Housing and Utilities Sector in the Russian Federation for 2002-2010'. Its major idea is that the reform of the complex and the relevant services may be successful if two initial preconditions are met:

- (a) Providers have sufficient revenues to cover at least operating and maintenance costs;
- (b) Consumers are willing and able to pay the costs of services they are charged for; consumers will be willing to pay as long as they feel services are priced fairly.

The sub-programme identifies five priorities:

- (a) Increase tariffs to the level of operating cost coverage by 2003;
- (b) Discontinue the current system of privileges and exemptions;
- (c) Establish a system of personalized housing allowances as protection for low-income families;

(d) Creating joint-stock companies for the management and maintenance of the housing stock;

(e) Privatizing utility companies.

(f)

An action plan was established to carry out the measures in three major stages.

Stage one: 2002-2003:

- Draw up an inventory of debts to identify the share and reasons of the debts caused by public institutions, correspondingly due to a lack of funds in the budget; find the resources to payoff these debts, but also introduce measures to receive the due sums from the households indebted to the service providers;
- Discontinue the subsidization of the housing and municipal service sector and introduce market prices for these services;
- Improve the social security system for residents.

Stage two: 2004-2005:

- Develop the principles of competition in the sector;
- Introduce professional management in the complex;
- Create instruments to monitor and regulate the activities of natural monopolies;
- Improve the financial and technical situation of the utility companies by introducing management through concessions;
- Introduce personal housing allowance accounts for all residents.

Stage three: 2006-2010:

- Attract private funding to the housing and municipal services sector;
- Propose instruments to ensure the stability of service providers;
- Make available different banking credits.

However, there have already been delays.