

MEMO ON THE OPTIONS FOR M SOCIALY VULNERABLE POPULATION

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Direct Subsidies vs. Inclining Block Tariffs (IBT)

Both options have certain advantages and disadvantages, and very often the decision to adopt this or that option depends on the balance of advantages and disadvantages in the given social and economic environment.

Usually in case of IBT you have a subsidized first block for which the tariff is below the cost price of the service. The subsidy normally is provided by large consumers (who are in higher blocks) to small consumers (who are in the first block). The seeming advantage of this option is that there is no need to identify the socially vulnerable families¹. However, the option has a number of disadvantages which have to be carefully considered before making a decision in favor of that option:

- There is a danger that quite many rich (not poor) people will benefit from the subsidized tariff.

Many rich households that have minimum number of family members do not use much water (they use laundry services, eat in restaurants, etc.). The number of such families is increasing every year parallel to improvement of social conditions in the country.

At the same time, most poor families make excessive use of water (do all the washing, cooking, baking, canning food, watering their little gardens to grow vegetable, etc.). A poor family that has more than 4 members will most likely use more water than a rich family of three.

- The poorest households in most cases do not have water meters installed and are billed based on normative consumption. In the absence of a water meter it will be impossible to determine in which block the consumption is. Thus, in any case, there will be a need for identification of socially vulnerable families and provision of direct subsidies (at least for the purchase of the water meter).
- Presumably the first block should refer to the minimum level of consumption based on internationally acceptable standards (which is around 80 liters per capita per day). If you look in the AWSC sales database, you will see that around 60% of the metered customers are below the 40 l/day/capita rate. It is not possible to subsidize as much as 60% of the customers. At the same time, it is not acceptable (for social and public health considerations) to reduce the minimum consumption below the international benchmarks.
- To have an effective IBT system you need to have a “critical mass” of large consumers. If the number of such consumers is too low (as it is the case in AWSC, Lori, Shirak and Nor Akunk) there is the risk that the tariff for the consumers in higher blocks goes really very high. Experience in some Latin American countries has shown that large customers subject to the most expensive block rates will curtail service from the water company if the rate is too high and find alternative water sources. This just exacerbates the ability to provide enough funds to subsidize the customers in the first block and threatens the utility’s financial conditions because it will have less revenue.

¹ Identification of socially vulnerable families is a very difficult task which involves application of all kinds of complex methodologies for calculation of family income.

- If the first block is set very low (see the previous paragraph) to keep the amount of subsidy low, there is the risk that such consumers as rural polyclinics, bakeries, kindergartens and schools automatically fall into the second block.

The main advantage of the direct subsidy method is that it targets subsidies to those customers that are socially vulnerable. The disadvantage of the direct subsidies approach is the additional administrative effort and costs that may be needed to identify the socially vulnerable families. However, the existing database of socially vulnerable families in the Ministry of Social Protection is more or less accurate. It will take just a little more effort and resources to improve and regularly update that database.

The attached document will provide information on how the direct method has been applied in Chile.

Recommended IBT mechanism

We are planning to recommend in our “Tariff Policy” an IBT mechanism that does not have most of the disadvantages listed above. In our opinion it is socially fair and economically sound. The main idea of this approach is the elimination of cross subsidies between different water systems for large consumers.

At present, AWSC operates many autonomous water supply systems (more than 40). The cost of water in each of these systems is different. The difference of the cost price in different systems can be as significant as 500%-1000% (for example: 50 drams in Sisian and around 500 drams in Dilijan). In this situation the cross subsidization between different systems is almost inevitable for social reasons. Hence, the PSRC sets one flat tariff for all service areas of the AWSC. This approach, however, is not very sound from economic point of view and not very fair from social point of view. For instance, the large commercial and industrial consumers in Dilijan or Kapan (where the water is expensive) make money by using drinking water which is subsidized by residential consumers in Sisian or Jermuk (where the water is relatively cheap). Thus, the large commercial consumers do not get a notion of the real price of water and are not motivated to save water where the water is expensive, neither are they encouraged to use water where it is cheap.

We propose to apply the current flat rate to the first (or basic) block, which should be fairly high to cover all the possible household needs according to the highest international standards (around 35-40 m³ per month). For all the consumption that is above the basic block the Local Tariff (LT) should be applied. The LT should be based on the real (cost) price of water in the given system. Thus, if the cost of water in the particular system is higher than the flat rate, the large business consumers will be motivated to save water (by applying more efficient technologies, by shifting to less water-consuming activities, etc). If the cost of water in the particular system is lower than the flat rate, the water company may negotiate with the business consumers a lower rate to encourage the consumption and to promote the development of businesses.