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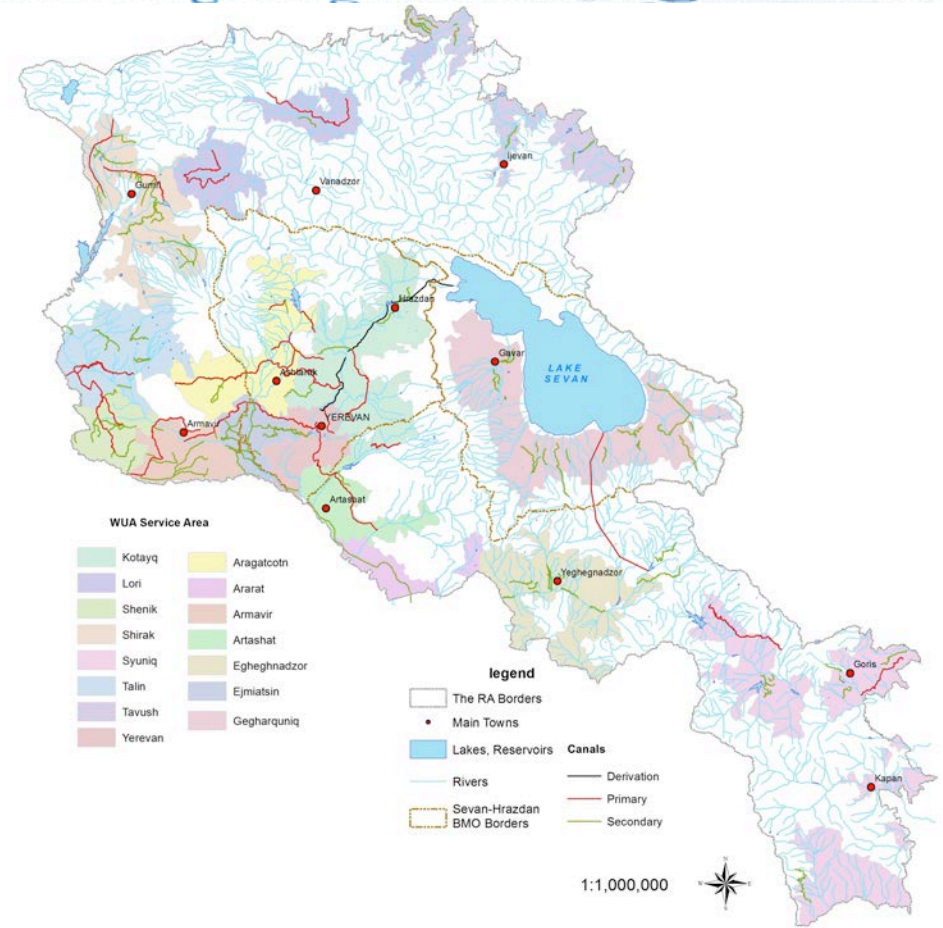


REFORMING “HARMFUL” IRRIGATION SUBSIDIES IN ARMENIA

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Background

- In 2015-2016 OECD conducted assessment of an environmental and economic value of water in Armenia
- Application of suitable method for assessing the economic value of water revealed number of challenges, including irrigation subsidies
- Preliminary recommendations: further improvement of the cost-recovery and increase of water tariffs, however, full cost-recovery would have unacceptable impact on farmers income in many WUAs
- Options to be further explored:
 - Maintenance of irrigation subsidies and their reduction to maximum level acceptable in terms of impact on farm income
 - Prioritization of irrigation investment supported by public funds, which may indirectly promote full cost-recovery of MOM costs of WUAs

Goals and objectives

- Overall goal
 - Support strengthening of water use efficiency in irrigation with a look into different business models and economic instruments to path the way towards sustainable water use in irrigation
- Specific objectives
 - To conduct detailed assessment of subsidies in the irrigation sector of Armenia
 - To investigate the main parties benefiting from the subsidies
 - To identify potential options of best allocation of state subsidies to different irrigation schemes
 - To develop recommendations to policy-makers on phasing out “harmful” subsidies in the irrigation sector

Irrigation sector reforms

- Since 1992 implementation of institutional improvements and projects aimed at creation of conditions for sustainable and efficient agriculture, regulated by market forces
- Agriculture is still the dominant sector of the Armenian economy, and is largely dependent on irrigation
- Despite prompt measures for privatization and liberalization of most agricultural sector, irrigation still remains priority issue among the challenges:
 - High cost of water delivery due to deteriorated state of irrigated system: high water losses, dependence of electricity
 - Lack of cost-recovery policy and absence of effective arrangements for provision of timely and adequate financing of MOM costs
 - Lack of adequate allocation of responsibilities and arrangements of participatory management policy

Chronology of irrigation sector reforms

- The transition phase
 - 1991-1993: agricultural lands, livestock and other production facilities were privatized
- The phase of unsteady steps
 - 1998-2001: first steps towards participatory irrigation management. About 150 WCCs were established, but financially unsustainably due to small service area
- The main phase based on international experience
 - Since 2002: Introduction of participatory irrigation management by water users (law on WUAs), transfer of major part of irrigation management functions to water users
 - Water Supply Agency in charge of bulk irrigation water supply
- Development or consolidation phase
 - Consolidation of WUAs using the same water sources of main irrigation systems under FWUAs (Portugal, Spain, Mexico) to develop the ideology of “single owner” in operation of the irrigation system and the practice of participatory irrigation management, which is not depended on the “state hand”

Allocation of irrigation subsidies

- Calculation of subsidies in irrigation sector is based on the cost structure, traditional **expense method** is applied
- Preconditions for providing subsidies to WUA
 - Maximal threshold for irrigation water fee (selling tariff)
 - Minimal irrigated area
 - Maximal threshold for payables which shall not exceed the level clearly defined by the agreement
- Currently the subsidies to WUAs are provided under an agreement to compensate for the electricity tariff
- WUAs shall not accumulate new debts and shall reduce their existing debts by 20% each year, in order to be able to receive subsidy

Allocation of irrigation subsidies

- Since 2006 all the subsidies have been directly provided to WUAs based on technical and financial indicators
 - Planned budgets, planned electricity consumption, technical state of infrastructure
- Summary indicators from 2006 until August 1, 2018:
 - Actually irrigation ha **reduced** in average by 2.4%,
 - Subsidies to WUAs have **increased** on average by 3.5%
 - Operational costs per 1 ha have **increased** on average by 4.4%
 - Current revenue from 1 ha has **increased** by only 5%, while the amount of state subsidy per 1 ha has **increased** by 6.8%
- In the period of 2006-2008 subsidies of about 170 mln USD were allocated to WSA and WUAs. On average, annually WUAs receive 2.4 mln USD and WSA 10.6 mln USD of subsidy

The need for reforming irrigation subsidies

- Why reform?
 - Easing the burden on the state budget
 - More efficient arrangement of state budget funding
 - Increase efficiency of WUA performance, including financial performance
 - Further develop WUAs into more independent and self-financed institutions
 - Successful international experience (USA, Columbia, Romania, India, Republic of South Africa, Zambia, Portugal, Indonesia, Sri Lanka)
 - Government Resolution No 188-N “On Fundamental Concepts of Improvement of State Financial Assistance to WUAs and on Approving Loss Norms for Delivered Irrigation Water” underlines: **currently the subsidies to WUAs are provided according to traditional expense method, which hinders efficiency improvement of WUAs, thus it is necessary to shift to alternative approach, using result-based grant provision.**

Recommendations on Reforming Subsidies

- Move from subsidies covering gap to subsidies, promoting local investments: strengthen service-rendering capacities
- Shift to preparation of a budget on the real MOM needs
- Develop strategy aimed at ensuring full-coverage of MOM
- Amend regulations to ensure other income sources for WUAs
- Change state budget funding purpose: periodical investments and not MOM costs
- Develop Government strategy to replace non-viable irrigated agriculture by profitable economic activity and more efficient use of subsidies
- Update subsidy policy in respect to non-viable irrigation entities in the frontier regions

Questions to be answered

- Is there currently a vision of adequate improvements, political will, need, substantiation, resources and legal framework?
- Will the introduction of new arrangements result in higher efficiency of WUAs (particularly, financial efficiency) and irrigation sector in general?
- Will the introduction of new arrangements result in higher efficiency of funding of some of programs financials from the state budget?
- Is there a need to change the content, structure or methods of providing funding the WUAs from the state budget?
- Will the introduction of new arrangements result in institutional development and capacity strengthening and maturation of WUAs and will it promote subsidies for local investments
- Will new arrangements ensure full cost-recovery of MOM activities of WUAs?

Main conclusions

- Positive experience in assisting WUAs possible to apply in Armenia with some adaptation:
 - Subsidies should be provided through adequate planning and supervision
 - In case of fulfillment of some conditions, WUAs may have the right to carry out commercial activities and get income from their assets
 - WUAs may be entitled for getting direct and indirect grants from the state, and get grants from the state or local budgets for development of their service areas
 - Gratuitous resources provided by the government and local authorities may be a source of income for WUAs
 - Government may directly compensate WUAs for delivery fees, provide funds to finance and co-finance rehabilitation and expansion of water supply systems – the extent of financial assistances should be based on the progress and results achieved by WUAs

Main conclusions (continued)

- Development of new arrangements for state budget funding to WUAs shall be based on the following principles:
 - Higher efficiency of irrigation sector, including improvement of financial efficiency and operational sustainability
 - Improved funding efficiency and clear reporting of programs implemented through the state budget
 - Institutional development and capacity strengthening of WUAs shall promote subsidies for local investments
 - Enhance full-cost recovery of MOM of WUAs



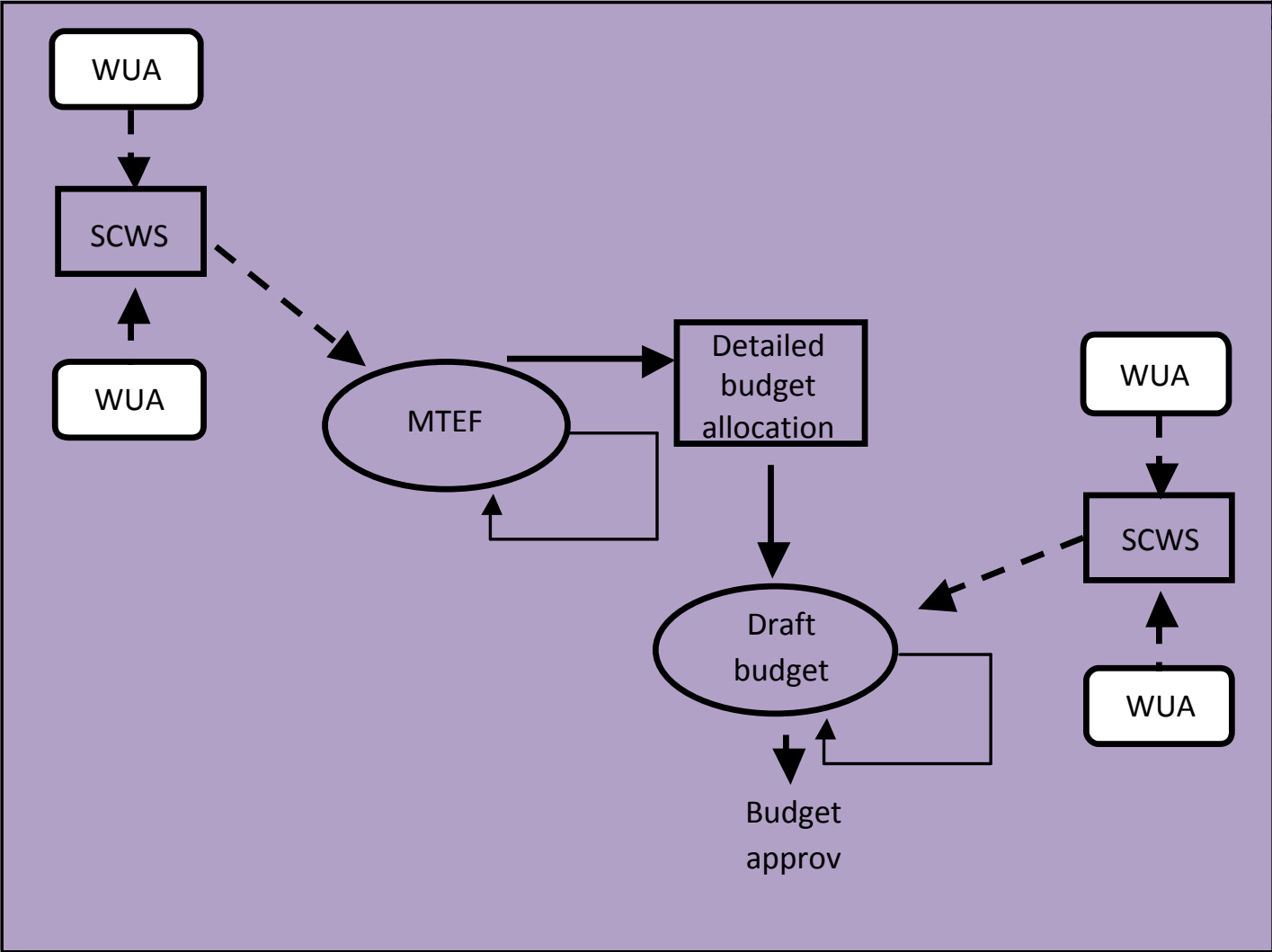
Improving subsidies - Option I

- WUAs become subjects of MTEF of the state budget of RA
- They submit application to the budget each year and plan spending budget lines according to methodological instructions specified for MTEF
- WUAs submit program indicators on financial-economic performance, and subsequently submit performance reports
- Funding will be implemented on a monthly basis through the Water Committee by transacting on the WUAs treasury account the amount of financial gap presented in the WUA monthly report

Improving subsidies – Option I

- Advantages of the first option:
 - WUA becomes a full member of the state budget program and carries out planning and reporting of its activities according to corresponding methodological instructions
 - Each month WUA submits all the baseline and technical data serving as a basis for monthly financial gap
 - Under this option the state has to set only one precondition – **the delivery of a specific volume** of irrigation water and define specific “**rule of games**” for paying against it
 - In case of implementation of this option, the development of **non-financial outcome indicators**, comprising part of application for funding from the state budget will get high importance
 - **Non-financial indicators** (quantitative, qualitative and time-based) will comprise an important part of the report on implementation of budget expenses by WUAs in order to improve the reporting level by WUAs and ensure the transparency of its performance in exchange of provided funding

Improving subsidies – Option I



Improving subsidies – Option II

- Water users will be provided with requested grants by the banks serving the sector, on the following conditions:
 - Water user open account at the bank, which has exclusive right to management that account. Water user pays his payable amount on his bank account and bank accrues on the water user's account the proportional amount of the grant provide from the strange budget on the WUA name
 - In case of getting respective powers, bank will process outstanding payable amount of water user as an interest loan, provided from the state budget through the bank on the name of the water users.
 - Bank actually acts as a financial agent of GOA, but on the other side – collecting agent

Improving subsidies – Option II

- Advantages of the second options:
 - WUA gets all fees for delivered irrigation water, which increases the level of financial sustainability and reduces payables risks
 - GOA may order water users to grow and sell to the state the required agricultural product, which will have maximal impact on GDP
 - Water user will directly see and feel the assistance of the state
 - The process of fund allocations from the state budget becomes more transparent



Thank you for your attention!

