

Case Study— Raja Constanta, Romania

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Key Characteristics of Aggregation Case Study

RAJA CONSTANTINA, ROMANIA	
Context	<ul style="list-style-type: none"> • Upper-middle-income country • Aggregation covering urban and rural areas • Medium level of WSS performance
Purpose	Performance, professionalization, environment benefits, economic efficiency, equity
Scope	WSS functions and services
Scale	<ul style="list-style-type: none"> • Administrative boundaries • Localities covered: 134 for water and 18 for wastewater • Population covered: 731,021 inhabitants for water and 485,660 for wastewater • Coverage: 98 percent for water and 87 percent for wastewater • Connections: 136,611 for water and 66,352 for wastewater • Network length: 3,710 km for water and 1,526 for wastewater
Process	Top-down with financial incentives
Governance	<ul style="list-style-type: none"> • Delegated (49 years) • Public company • Decision making: The County Council holds 97 percent of utility shares, and 33 municipalities hold the remaining 3 percent, according to the water volume distributed in each settlement. • Asset transfer: Assets remain the property of local and county authorities, and are being transferred to the operator for the duration of the delegation contract. • Liability: Liabilities and debts from previous operators were not taken over by the aggregated utility. • Staff transfer: All staff were to be transferred to the aggregated utility. • Clear entry and exit rules

In 2006, Raja Constanta was among the first water supply and wastewater (WSS) utilities in Romania to implement the top-down aggregation reform designed by the central government, as it was perceived as a great opportunity to develop investments, expand operating area, and consolidate leadership among public water operators in Romania. Despite the quality of the dialogue between some local authorities and Raja Constanta, which is directly reflected in the success of this aggregation, a decade after the process started, there was still a strong political resistance opposing what was perceived by some municipal representatives as a loss of power and control.

From Fragmentation to Aggregation of WSS Utilities in Romania

The water sector in Romania has followed a contrasting evolution, fluctuating between fragmentation and aggregation. Before the 1990s, Romanian water services were supplied at the county level by companies that were also providing other public services such as solid waste collection, heating, and so on. Water infrastructure investments were entirely subsidized by the central government budget, and operational costs were subsidized by local authorities or through cross-subsidies, with industries paying a higher tariff than institutions and domestic users. Immediately after the fall of the socialist system (in 1989), the operating areas of these services started to narrow down, as local authorities each wanted to have their own public service operators. As a result, hundreds of WSS utilities were then created. In a reverse movement, a comprehensive water sector aggregation reform was designed in 2005-2007 and implemented during the five following years. This regionalization consisted of a top-down mandatory process incentivized by EU investment grants as Sectoral Operational Program for the Environment (SOPE) funds were allocated only to projects led by a regional operator. From an institutional perspective, the regionalization was generally performed through the reorganization of public services operated by the capital city of the county.

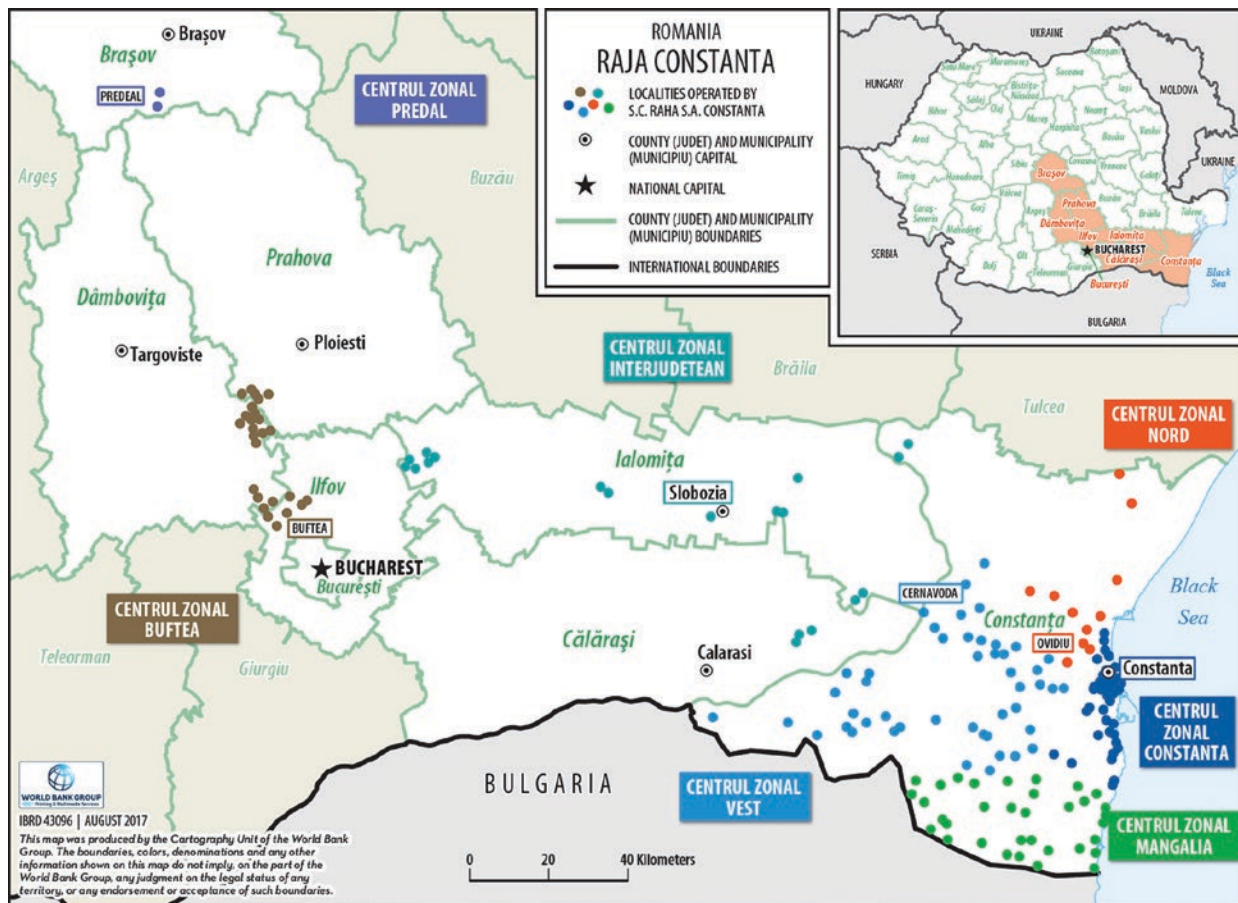
The process had two stages. The first consisted of the concentration of the operation of services provided to a group of municipalities at county level. The second, which has not been achieved yet, aims to concentrate these county utilities further, into river basin utilities.

The overall aggregation reform is based on three key institutional elements: an intercommunity development association (IDA), a regional operating company (ROC), and a contract of delegation of services. The IDA is the sole interlocutor of the ROC, representing the common interests of its member municipalities regarding water and wastewater services, especially with regard to general strategy, investments, and tariff policy. The ROC is a commercial company, owned by the IDA member municipalities, to which the management of the water and wastewater service is delegated through a delegation contract. The ROC is thus appointed to manage, operate, maintain, upgrade, renew, and expand, where appropriate, all public assets designated in the contract. It collects the invoices paid by customers, in accordance with the contract provisions. The purpose for aggregation in Romania, as stated in the official Guide on Regionalization, is the “improvement of sector performance by a better management and professionalism, as well as benefiting from scale economies.” However, in the views of the European Commission and the Romanian government, the regionalization process was also a means to promote integrated water resources management in order to comply with EU directives and create environmental benefits. It was as well a way to set up financial solidarity through cross-subsidies at the county level, and to offset decreases in water sales. Service quality and technical capacity enhancement were also targeted, especially because large investment projects were planned.

Raja Constanta, a WSS Utility Controlled by the Constanta County Council...

Constanta is one of the most important cities in Romania, with a powerful economy. It is the largest

MAP 1. Municipalities Served by Raja Constanta



port on the Black Sea and the Romanian Riviera. Its water operator, Raja Constanta, which was already one of the largest water utilities in the country, took advantage of the EU SOPE investment program to upgrade its infrastructure and expand further its service area. Some attempts were made to operate in Moldova and to prospect markets in neighboring countries.

In 2007, Raja Constanta was turned into a commercial company owned by public local authorities, as required by the aggregation reform provisions. Such a legal evolution was to transform utilities into business-oriented entities, financially autonomous from municipal budgets. The County Council received 97 percent of the ROC shares, and the 33 municipalities¹ served by Raja Constanta hold the remaining 3 percent, allocated according to the water volume distributed in each settlement.

As a result, the company is under the sole control of the County Council, which is common in Romania, as most ROCs are controlled by counties or county capitals. According to Romanian law,² the ownership of public WSS assets remains in the hands of local and county authorities, and they receive a royalty fee to be used to cover the infrastructure debt repayment. Assets were not part of the ROC capital and therefore did not confer any shareholder right. This caused confusion and dissatisfaction among some decision makers, as some of them would have liked to retain more control over the operator.

The regionalization process led by Raja Constanta was relatively smooth and spread until 2014. The process was greatly stimulated by the fact that aggregation was an eligibility criterion for access to SOPE and European

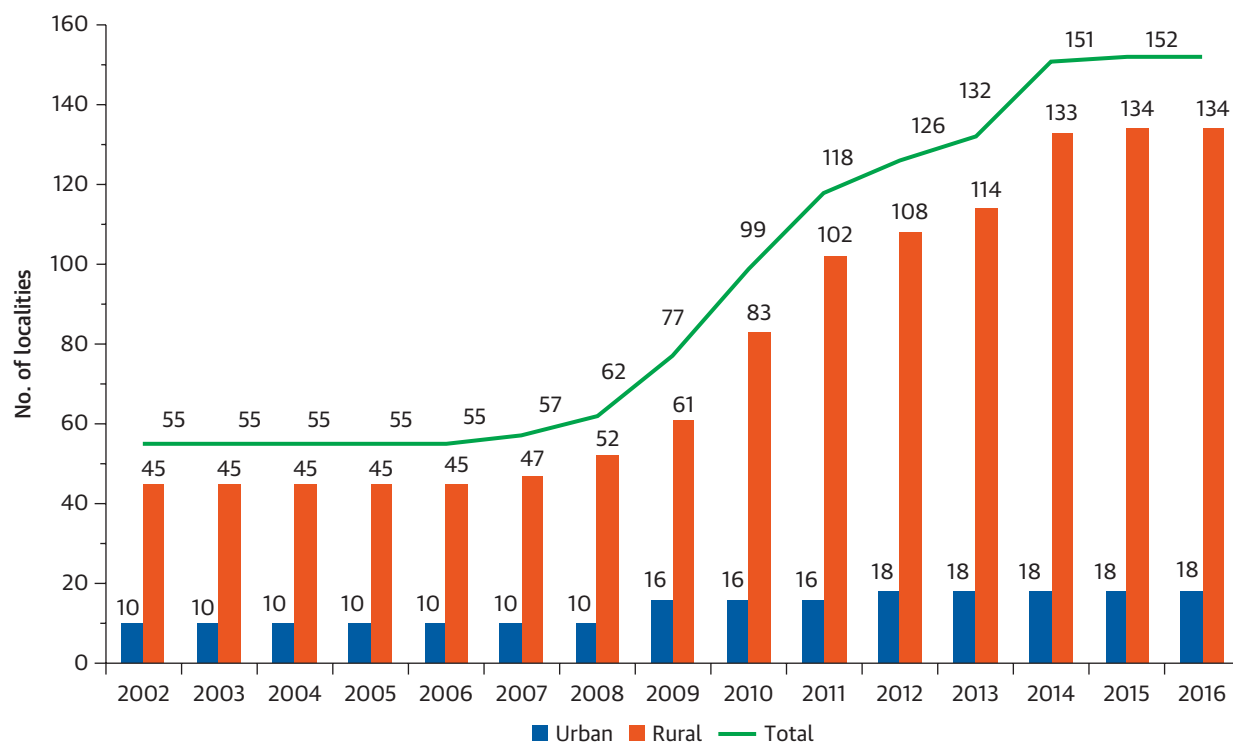
Bank for Regional Development funds. Hence, Raja Constanta decided to take over services in localities benefiting from these funds and to cofinance investments. The process was also stimulated by Raja Constanta's decision to take on all former staff, provide increased salaries, and commit to not make any redundancy during the first two or three years of operation. However, some of the services taken over were heavily overstaffed. As a result, the number of Raja Constanta employees increased by nearly 50 percent and labor costs doubled.

In 2013, in order to decrease the number of employees, the company launched a restructuring plan, using a human resources consulting firm. As a result, 626 employees were dismissed, which amounted to 25 percent of the total number of employees at the time. The collective dismissal process complied with all labor law provisions and was carried out with full transparency and communication with unions and staff over a 10-month period. Social movements and protests were avoided. Only eight legal actions were filed by former employees, and all were won by the operator.

TABLE 1. Evolution of Personnel Expenses, Number of Staff, Population Served, and Number of Connections in the Area Serviced by Raja Constanta

Item	2007	2008	2009	2010	2011	2012	2013	2014	2015
Personnel expenses (000 lei)	40,626	51,337	51,223	64,197	81,188	92,017	99,799	103,557	91,227
No. of staff	1,804	1,888	1,952	2,419	2,652	2,676	2,787	2,700	2,201
Population served	498,376	501,843	607,650	626,298	690,630	695,100	705,996	739,007	731,021
No. of connections	75,050	81,893	108,894	116,721	121,727	125,727	127,097	135,940	136,611

FIGURE 1. Evolution of Raja Constanta Service Area Before and After Aggregation



... But Spreading over Seven Counties

Compared with other operators in Romania, Raja Constanta has the specificity to have implemented investment projects in neighboring counties, thus expanding beyond the strict limits of Constanta County. As a result, Raja Constanta took over localities from seven counties where operators lacked the technical capacity to operate WSS systems and to invest. In September 2008, Raja Constanta was providing water services to approximately 500,000 inhabitants in 57 localities. Six years later (in 2014), the operator served 750,000 people in 152 cities, towns, and villages.³ During the same period, the number of residents receiving sewerage services increased from 365,000 to over 485,000. Nearly 95 percent of wastewater is now treated in 15 upgraded wastewater treatment plants that conduct secondary treatment.

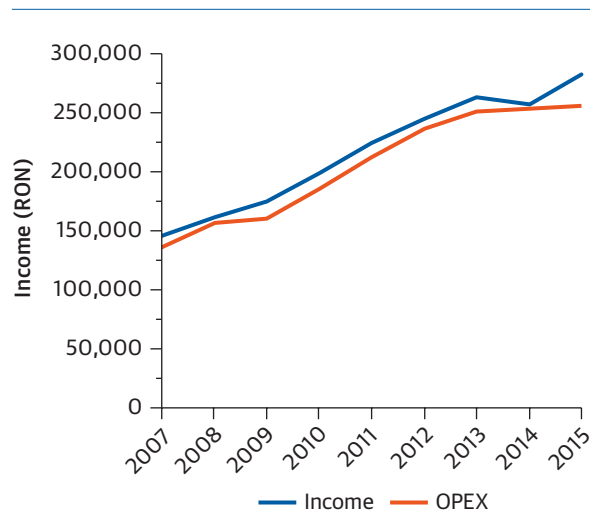
The scale of aggregation was first shaped by the SOPE funds, as Raja Constanta expanded in municipalities benefiting from those funds, whether they belonged to Constanta County or to other counties. It took over all water services and functions in localities where there was no wastewater treatment or only dysfunctional facilities, and limited water and sewerage systems. One of the rationales for the scale of aggregation was to create or develop WSS infrastructure. Water systems have been physically interconnected as much as possible in several areas. Along with its expansion, Raja Constanta made structural changes to the organization of its seven regional centers to keep costs under control and improve teams' work response. Whenever taking over a new service, Raja Constanta integrates the new service activities (billing, accounting, legal services, quality control, and so on) within its existing departments. In 2010, it created a supervisory control and data acquisition (SCADA) center that enables remote access and control of large-scale processes related to WSS systems in multiple sites and over large distances. In 2016, the local dispatches were abolished, replaced by a central dispatch that customers can reach using a unique

phone number. This central dispatch coordinates and monitors all field interventions.

A Positive Outcome for the Regionalization Process Led by Raja Constanta

Municipalities where the service has been taken over by Raja Constanta have witnessed a dramatic improvement in terms of technical capacity, environmental benefits, equity, and service quality. Since Raja Constanta took over, WSS systems have been rehabilitated or replaced. New wastewater treatment plants have been built, and the new service has been upgraded to European standards. All assets have been inventoried in a database connected to geographic information systems. Accounting practices have been improved. A medium- and long-term investment plan has been elaborated. In some municipalities, prior to the regionalization, the service was not continuous and water was being delivered according to an intermittent, pre-defined program. When Raja Constanta took over, service was provided continuously, regardless of costs. In terms of economic efficiency, the outcomes of the aggregation show an increase in both the revenues and OPEX of Raja Constanta.

FIGURE 2. Evolution of Income and OPEX



Note: OPEX = operating expenses.

FIGURE 3. Evolution of Staff Productivity and OPEX Structure After Aggregation

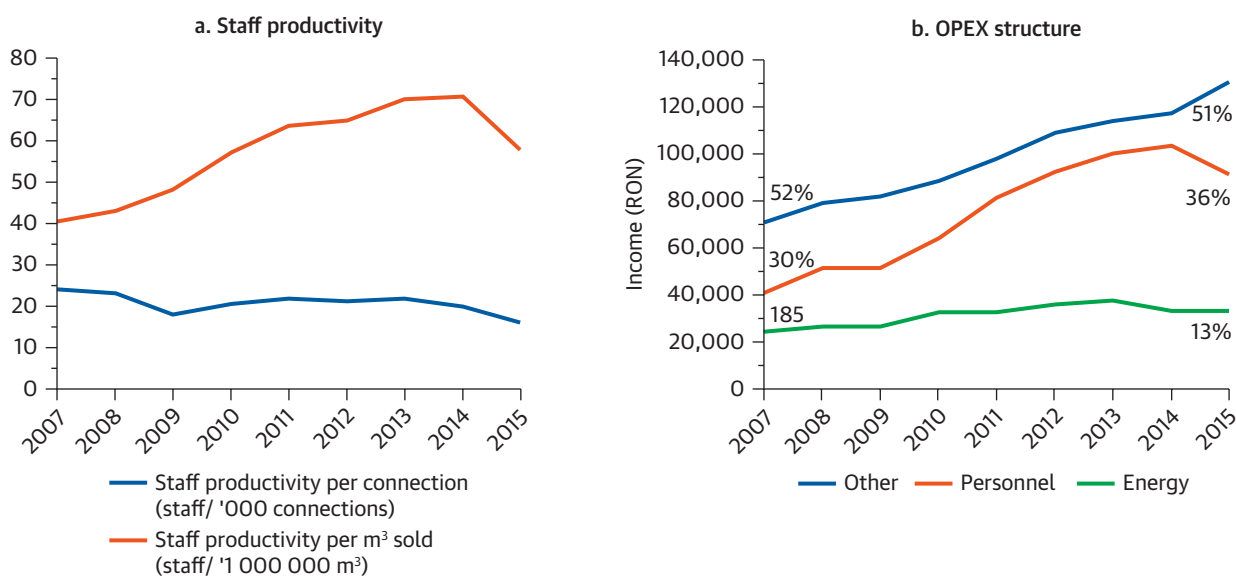


TABLE 2. Water Services

	2007	2008	2009	2010	2011	2012	2013	2014	2015
OPEX/connection (RON/con.)	843	912	704	732	837	920	965	865	854
OPEX/water sold (RON/m³)	1.42	1.70	1.90	2.02	2.44	2.81	3.08	3.07	3.06

TABLE 3. Sewerage Services

	2007	2008	2009	2010	2011	2012	2013	2014	2015
OPEX/connection (RON/con.)	662	636	543	565	680	721	712	647	705
OPEX/water billed (RON/m³)	0.71	0.81	0.87	0.88	1.10	1.15	1.33	1.44	1.53

The evolution of OPEX was driven mainly by the staff transfer agreement, which happened to be a financial burden for the company. Later, some efforts were made to improve staff productivity and to lower energy costs. In addition, to supply water, Raja Constanta is extracting it from underground, which entails high electricity consumption.

Comparing OPEX per connection and OPEX per unit of water sold shows even greater contrast. For water and wastewater, OPEX per water sold or billed more than doubled from 2007 to 2015, whereas OPEX per connection is increasing for wastewater and staying steady over time for water.

However, the evolution of quality criteria is unambiguous, as coverage and quality of service clearly increased from 2007 to 2015.

A Strong Determination to Overcome Long-Lived Political Resistance and to Achieve Quality Improvements

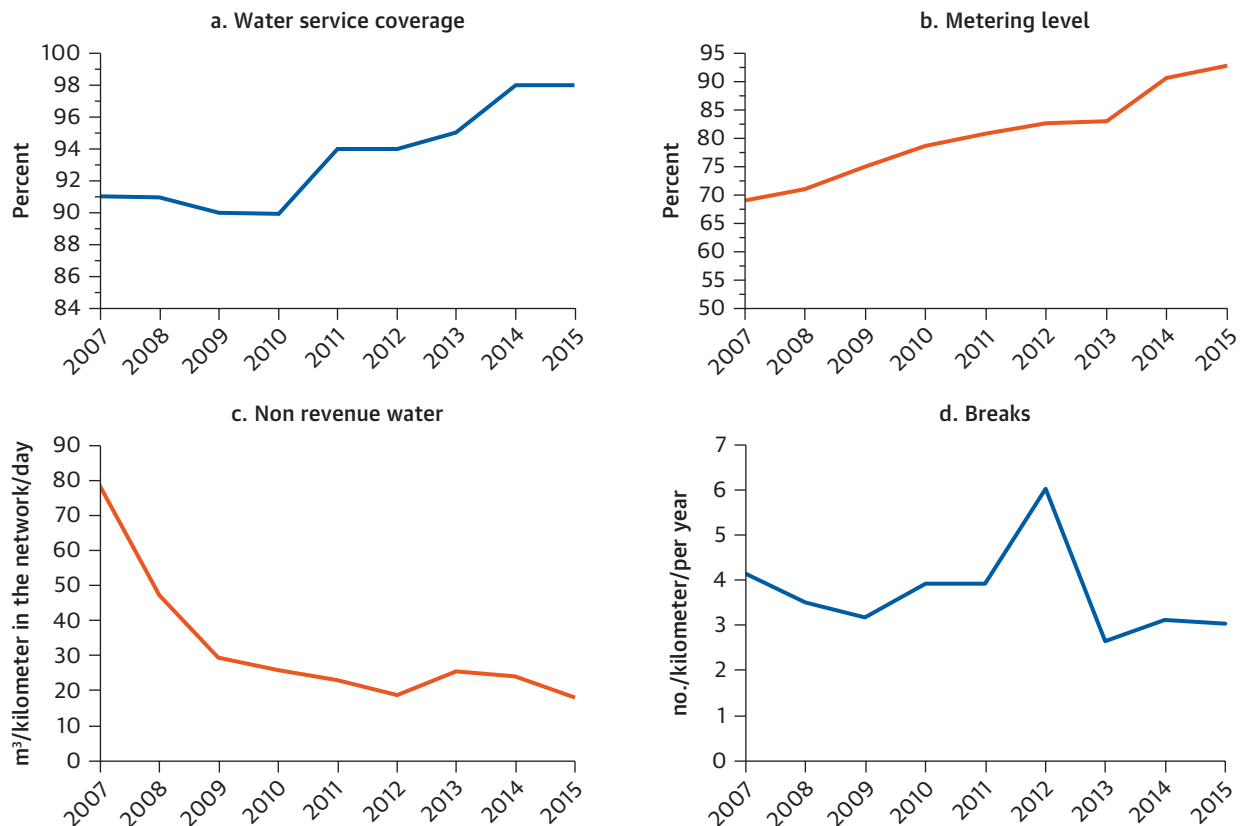
The Constanta County Council and the city of Constanta supported the operator and the investment projects throughout the whole regionalization process. However, owing to the pressure to absorb EU funding, the national aggregation reform was passed quickly, which did not allow for proper information and

engagement with local authorities and citizens. The government prepared master plans for each county and did not have time to complete them with more comprehensive technical and economic data informed by local governments. As a result, Raja Constanta experienced some resistance, as the regionalization process was perceived by some local representatives as a loss of control over the WSS utility. Hence, 10 years after the beginning of the process, the operator's determination and capacity to overcome political resistance was abruptly tested.

In 2016, the city of Cernavoda was virulently against the tariff increase policy although it benefited from a new water supply system with high-quality water extracted from underground sources and financed by SOPE funds. The Cernavoda City Council unilaterally adopted a decision to halve the water price. Although the decision was unlawful, it was adopted

unanimously. However, Raja Constanta continued to charge fees according to the tariffs stipulated in the delegation contract, and the resistance was overcome. The operator's determination to implement the aggregation and stick to the contract provisions was decisive in overcoming obstacles and achieving the most intensive aggregation in Romania. This would not have been possible without the constant support of the main shareholders of the utility. Moreover, the stability of the executive management—which had remained unchanged since 2003—gave great credibility to the operator and underscored its leadership. As of today, Raja Constanta has achieved improvements in service coverage and quality as well as technical capacity. But heavy transaction costs related to staff transfers as well as increasing OPEX due to large investment projects have not allowed the utility to improve economic

FIGURE 4. Evolution of Raja Constanta Key Performance Indicators After Aggregation



efficiency yet. However, utility directors managed to implement a tariff policy allowing the utility to cover operating costs. EU financial incentives fully benefited the utility and its customers, with an investment program of €278 million being implemented. As a result, services taken over by Raja Constanta have managed to get out of the low-level equilibrium trap, thus breaking the vicious cycle of low price-low quality. Last but not least, governance arrangements proved effective and robust enough to address political issues, to implement large investment projects, to set up a policy on increasing tariffs, and to enhance the overall performance of the service.

Aggregation Case Study at a Glance

Key Lessons Learned from Aggregation Case Study

Staff Transfer Can Generate Heavy Transaction Costs, which Can Hamper Aggregation Success

Transaction costs occurring before, during, and after aggregation can hamper aggregation success, or limit and delay the materialization of its benefits. In the case of Raja Constanta, staff transfer from former municipal structures into the newly aggregated utility generated heavy transaction costs which translated into significant and long-lasting labor cost increases.

Financial Support and/or Incentives Are Important to Help Services Get Out of the Low-Level Equilibrium Trap ("Big Push")

In Romania, the Ministry of Environment took the opportunity of EU funding to establish coercive eligibility criteria that helped trigger and speed up the aggregation reform, namely a Guide on Regionalization and Guidelines for Applicants to SOPE Funds. The scale of aggregation of Raja Constanta was shaped by the SOPE funds, as the utility preferentially expanded in municipalities benefiting from those funds, whether they were in Constanta County or not. As a result, Raja Constanta accessed an overall amount of €278 million in investment subsidies.

Aggregation Forces More Explicit Decision-Making Processes, Leading to Better Corporate Governance

Aggregation involves the creation of a new, separate organizational entity that is accountable to more than one stakeholder. Therefore, aggregations present an opportunity to adopt sound corporate governance principles related to autonomy and accountability. Raja Constanta has been turned into a commercial public company as a result of the regionalization reform.

Having a Stable Leader or Champion throughout the Aggregation Often Improves the Likelihood of Success

The Constanta County Council and the city of Constanta supported Raja Constanta throughout the whole regionalization process. Moreover, the general manager of Raja Constanta is an important local and national leader in the water sector, with extensive experience in public administration and in business entrepreneurship in the private sector. He used to be the deputy mayor of Constanta, and as such he directly took part in the water sector institutional reforms. In 2013, he became the president of the Romanian Water Association. Having such a leader proved crucial to overcoming political resistance when a municipality opposed a water tariff increase by unilaterally halving the price. Raja Constanta continued to charge fees according to the delegation contract provisions and received the support of the utility shareholders. Moreover, the stability of the executive management, which has remained unchanged since 2003, gave great credibility to the operator, ensuring its leadership.

Notes

1. Only some of the localities served by Raja Constanta are shareholders of the company; these localities are the ones that were served by the utility prior to the aggregation process.
2. Law n° 213/1998 on public property and its legal regime.
3. A local authority could consist of more than one locality; therefore, the number of localities covered by Raja Constanta is higher than the number of local authorities.



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