

**Private Sector Participation
in Water Infrastructure**

Checklist for Public Action



This checklist forms part of the OECD publication
Private Sector Participation in Water Infrastructure:
OECD Checklist for Public Action
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Find out more at
www.oecd.org/daf/investment/water

An illustration on the left side of the page depicts a network of orange and grey pipes and a valve. A large blue water droplet is shown falling from the pipes, with a globe of the Earth inside it. The globe is light blue with white outlines of continents. The pipes are stylized and geometric, with some sections in shades of orange and others in grey.

Foreword

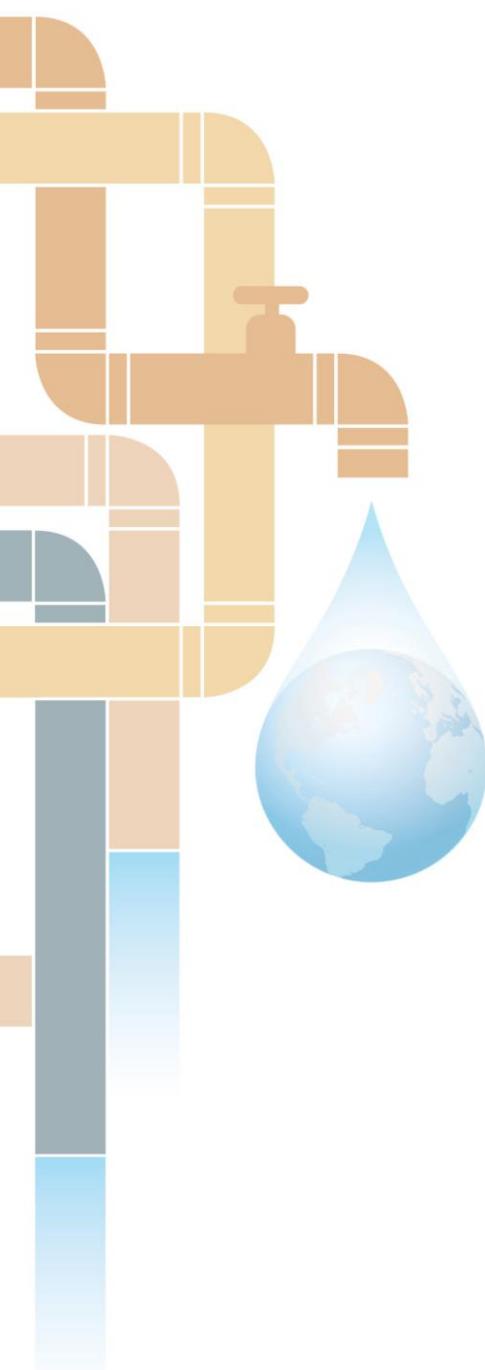
Worldwide, over a billion people lack access to drinking water and 2.6 billion to basic sanitation. Developing and managing water and sanitation infrastructure constitutes an urgent and major challenge. Just halving the proportion of people without access to drinking water and sanitation by 2015 would require investments of some USD 72 billion per year.

To meet these tremendous needs, many countries seek out the private sector to modernise and expand their water and sanitation infrastructure and/or to improve the efficiency of water systems. To make the most of private sector participation, an effective regulatory framework should be in place and key principles of good partnerships should be followed.

Recognising this, the OECD has developed practical guidance for governments wishing to engage the private sector in water infrastructure, building on the *OECD Principles for Private Sector Participation in Infrastructure*.

This booklet contains the guidance in the form of a checklist which outlines the main policy considerations unique to private sector participation in the water and sanitation sector. It is extracted from the publication, *Private Sector Participation in Water Infrastructure: OECD Checklist for Public Action* which also contains a scoping paper and a regional analysis.

This initiative constitutes one element of a major OECD-wide programme on water policies for affordable services and sustainable resource management. It complements recommendations developed by the OECD on pricing and realistic financing strategies.

An illustration on the left side of the page shows a network of orange and grey pipes. A large blue water drop is positioned in the center, with a globe of the Earth inside it. The globe shows continents in light blue and oceans in white. The pipes are stylized and geometric, with some having valves or joints.

Introduction

Organised around the 24 OECD Principles for Private Sector Participation in Infrastructure, this Checklist for Public Action aims to help governments wishing to engage the private sector in the development and management of water and sanitation infrastructure. For each Principle, the Checklist lists the key specificities of the water and sanitation sector; the corresponding issues for governments; and some available tools and country practices. It highlights five areas of key importance for consideration by governments:

1. Deciding on the nature and modalities of potential private sector involvement;
2. Providing a sound institutional and regulatory environment for infrastructure investment;
3. Ensuring public and institutional support;
4. Making the co-operation between the public and private sectors work in the public interest;
5. Encouraging responsible business conduct.

Four main messages emerge from the application of the Principles to the water sector.

1. Clarify the ultimate objectives for service provision and the opportunities and risks involved in private sector participation.

The choice (**principle 1**) between different modes of service provision is a means to an end: ensuring access to sustainable and affordable services. It should follow an initial consensus on the service provision desired by society, an assessment of where and how private partners can add value and determination of the modalities of their participation. Quantitative tools exist, such as the Public Sector Comparator, which combined with qualitative analysis, can help governments better define the costs (including contingent liabilities) and benefits associated with private sector participation and can support policy dialogue on this issue. In some countries, the private actors are already catering for sections of the population on an informal basis or with little visibility – including the small-scale operators and the big users. The issue for governments is not only to decide upon private sector involvement. They also need to consider ways to ensure greater insertion of existing private activities into the formal chain of service provision and include them in the oversight mechanisms.

In order to reach the objectives, a wide range of risk sharing arrangements is available to policy makers, from the public sector assuming most of the risk to significant risk transfer to the private sector. Tailor-made models of private sector participation should take account of local specificities and make the best of private partners' strengths (**principle 3**).

An appropriate risk allocation should be driven by an assessment of the party best able to manage risk (the party best able to influence the probability of occurrence or to deal with its consequences), so as to ensure value for money and the sustainability of the partnership **(principles 2-4)**.

The success of a model can be assessed only in the long run when sustainability and adaptation to changes can be proved.

2. Develop a conducive framework based on high-quality regulation, political commitment (including to fight corruption) and an adequate allocation of roles and responsibilities.

Private participation in the water sector does not exclude a role for government. Indeed, the government has the essential responsibilities of establishing adequate policy and regulatory frameworks, institutions and contractual arrangements and overseeing their functioning **(principle 17)**. It has the ultimate responsibility of meeting population's basic needs **(principle 5)**. This is valid regardless of the private or public nature of service providers.

In that context, strong political commitment remains critical, notably in the fight against corruption **(principle 6)** and in addressing lack of access to water and sanitation and service affordability. A major lesson from past experience is the need to clarify the different roles for the public sector: political function, administration, regulation and operation of service delivery. A second important challenge is to ensure policy coherence. Water and sanitation infrastructure development is indeed closely related and dependant on other policies such as urban development, energy policy, etc. In particular, such infrastructure development should very often be addressed as part of an integrated urban planning programme that tackles housing, property right tenure and, where relevant, relocation.

In addition, water is a segmented sector, with oversight responsibilities for resource management and service provision often split horizontally between different Ministries, and vertically across national, regional and local authorities. This may raise important capacity challenges and also generate issues of consistency across government levels. Careful allocation of roles and responsibilities is needed across different authorities, taking into account existing capacity gaps, and based on resources allocated in line with duties and distributed in a predictable way **(principle 10)**. Preserving consistency across government policies also involves strengthening co-ordination mechanisms across government levels **(principle 12)** and building common understanding across levels of government on the objectives, means and resources for water provision **(principle 11)**. Regular monitoring and performance assessment can also help define capacity building needs and contribute to a better understanding of objectives.



3. Root the partnerships in strong accountability mechanisms, through clear and consistent contractual arrangements, monitoring and relations based on information-sharing and consultation with stakeholders.

Contractual arrangements with the private sector in the water sector are typically long-term and as such not likely to cover all aspects of the complex relationship between the private sector and the public sector. Many past difficulties have also arisen from dispute over the real state of water systems and the quality of baseline data. No contract can be comprehensive enough to eliminate all elements of uncertainty.

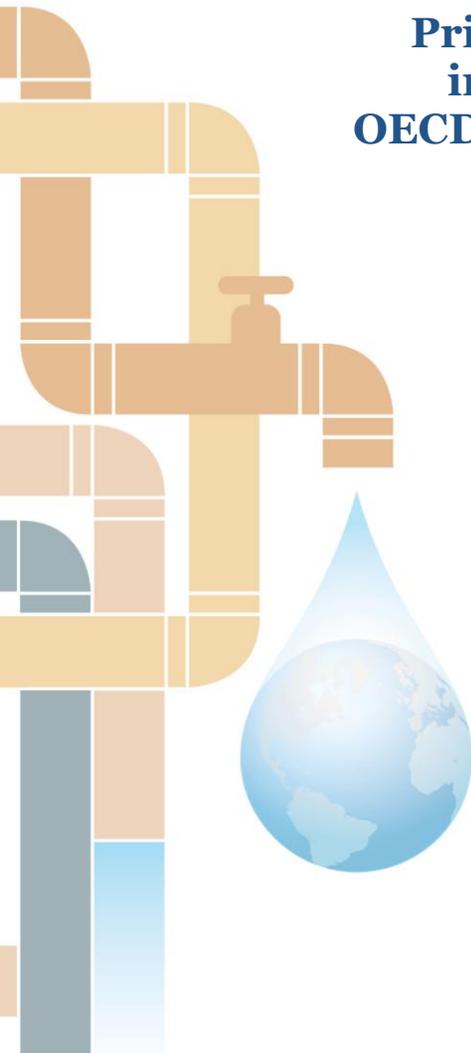
Mechanisms exist that may help reduce the uncertainty that comes with long-term incomplete contracts or deal with its consequences. They include: adopting performance based contractual arrangements (**principle 16**); providing for clauses and mechanisms to frame the discussions on future issues as well as formal dispute resolution mechanisms (**principle 19**); strengthening competitive pressure (**principle 7-15**) and promote information sharing (**principle 14**). Monitoring processes can also contribute to reducing uncertainties when they are focused on a small number of key indicators that are clear and easy to measure. In any case, good faith and willingness of the parties to cooperate and find solutions will remain crucial. In that context, starting the discussion early when challenges arise and before conflicts escalate can help diffuse the tensions (**principle 18**). Engaging the private actors to formulate their requirements and constraints can promote mutual understanding and better appropriateness of contracts (**principle 13**). Past experiences have shown that partnerships should not be viewed as simply a bilateral relationship between the public and the private sector as they generate strong interest from consumers and communities. Greater involvement of civil society (NGOs, consumer groups) may contribute to developing a feeling of ownership on the part of the users and the communities, to better protection of consumer rights and to monitoring service provision (**principle 9**). Public consultation should be developed according to the principles of clear focus, representation and transparency. It requires time and resources and, therefore, should be organised strategically at important stages of policy-making and preferably start at the early stage of the projects. It may also require providing adequate training.

4. Private actors also have an important role to play and responsibilities in ensuring the sustainability of partnerships and that their contribution can make a difference in improving the lives of millions of people.

Water, as a vital good involving important economic, social, environmental and political repercussions, requires strong commitment on the part of the private partners to responsible business conduct (**principle 20**) and to participate in infrastructure projects in good faith (**principle 21**).

Businesses have a critical role to play to promote integrity (**principle 22**) by engaging in timely, reliable and relevant information disclosure on activities, structure, financial situation and performance (including participating with good faith and commitment in due diligence processes) and supporting the development of a high quality regulatory framework while avoiding undue involvement in local politics. Showing a strong anticorruption commitment also involves going beyond communication on anti-corruption policies and internal management systems to the staff. A new corporate culture that provides incentives to stop corrupt practices should be established.

Companies also have an important role to play in evaluating the social and environmental impacts of their activities (**principle 24**), mitigating the potential negative impacts and contributing to the country's development goals. They can contribute to the assessment and discussion of the consequences for the poor of technology choices, tariff setting policy, and planned investments. They can also evaluate the impacts of activities on the environment and continuously seek to improve environmental performance. The difficulty lies with the set of indicators that are chosen to support their evaluations of social and environmental impacts. Following internationally-agreed guidelines such as the Global Reporting Initiative can facilitate the monitoring and comparison across companies. In addition, if private actors have a role to play in terms of local capacity building and the transfer and diffusion of technologies and know-how, this should take place in the context of national discussions on appropriate levels of service and technology, as technology choices may lock-in country service provision profiles for years. Finally, being responsive to clients' claims (**principle 23**) and providing transparent and effective procedures to address complaints can contribute to building mutual understanding and improving service provision.



Private Sector Participation in Water Infrastructure: OECD Checklist for Public Action

Principles 1-4

Deciding on public or private provision of infrastructure services

1. Informed and calculated choice.
2. Financial sustainability of infrastructure projects.
3. Apply tailor-made model of private sector involvement.
4. Preserve fiscal discipline and transparency.

Principles 5-8

Enhancing the enabling institutional environment

5. Enabling environment.
6. Fight against corruption.
7. Create a competitive environment.
8. Facilitate access to financial market.

Principles 9-12

Goals, strategies and capacities at all levels

9. Consultation with stakeholders.
10. Empower authorities responsible for privately-operated infrastructure projects.
11. Clear and broadly understood objectives and strategies.
12. Mechanisms for cross-jurisdictional co-operation.

Principles 13-19 Making the public-private co-operation work

13. Establish communication and consultation with private sector.
14. Full disclosure of project related information.
15. Fair, non-discriminatory and transparent awarding of contracts.
16. Output/performance based contracts.
17. Competent, well resourced and independent regulatory bodies.
18. Allowing for good faith, transparent and non-discriminatory renegotiations.
19. Setting dispute resolution mechanisms.

Principles 20-24 Encouraging responsible business conduct

20. Responsible business conduct.
21. Good faith and commitment.
22. Fight against corruption.
23. Communication with the consumers.
24. Awareness and responsibility for the social consequences of actions.

Deciding on public or private provision of infrastructure services

Principle 1

Informed and calculated choice.

The choice by public authorities between public and private provision should be based on cost-benefit analysis taking into account all alternative modes of delivery, the full system of infrastructure provision, and the projected financial and non-financial costs and benefits over the project lifecycle.

Sector-specific features

Basic human need and economic good.

Major resource and input for business.

Important externalities on health, education, environment, gender balance.

Important data and information deficits.

Combination of some large and small-scale projects.

Necessity of a global view considering all segments of water provision.

Wide disparities in initial conditions across countries / regions.

In most developing countries, private small-scale providers already cater for large portion of population (the poor and the scattered), often on an informal basis.

Considerations for governments

The choice between different modes of service provision is a means to an end: **ensuring sustainable access**. It should follow an initial consensus on the definition of service provision (level, location, development) desired by society, an assessment of where and how private sector can add value and the definition of the modalities of the participation (financing, service management). Governments remain in charge of the regulatory and oversight functions and of the ultimate responsibility to meet population's basic needs.

Sustainability analysis should address health, environment, economy, socio-culture and technical issues (including the choice of technology and the assessment of the current state of infra-structure). This analysis should consider the full water cycle, including treatment, distribution, collection, transport and end-management of wastes, water allocation across different uses and technical options (centralised vs. decentralised systems, water conservation vs. development of infrastructure).

Tools, such as the public sector comparator, that provide a **quantitative appraisal** can be useful when used in conjunction with qualitative analysis and baseline information is clearly disclosed, to better define the costs and benefits associated with private sector participation and forge a consensus among the stakeholders on the key elements required for an affordable and beneficial partnership.

A thorough analysis by project might not be feasible because of associated transaction costs (including time and capacity development).

Abbreviated or group appraisal and standardisation of contracts might help alleviate costs, especially for smaller projects.

Early identification of the consequences of choice (notably for different users) facilitates **balancing the different interests**.

Better **integrate the private actors** that already contribute – including the small-scale operators and the big users – in the chain of service provision.

Tools and practices

PPP for Water Supply and Sanitation,

Swiss Co-operation and BPD:
www.partnershipsforwater.net

Approaches to Private Participation in Water Services:

A Toolkit, PPIAF 2006:
rru.worldbank.org/Toolkits/WaterSanitation

Toolkit for pro-poor

Municipal PPPs, UNDP:
www.margraf-publishers.com/UNDP/PPPUE

Public Sector Comparator

(in Partnerships Victoria Guidelines):
www.partnerships.vic.gov.au

Deciding on public or private provision of infrastructure services

Principle 2

Financial sustainability of infrastructure projects.

No infrastructure project, regardless of the degree of private involvement, should be embarked upon without assessing the degree to which its costs can be recovered from end-users and, in case of shortfalls, what other sources of finance can be mobilised.

Sector-specific features

Long-term, irreversible investment.

Lack of transparency and complexity due to provision of subsidies and cross-subsidies, numerous layers of stakeholders and information asymmetry.

Complexity of pricing policy with potentially conflicting objectives: cost recovery, economic efficiency, equity and affordability.

The economic, social and environmental benefits of adequate access to water are not fully recognised. Consequently, water prices rarely reflect costs.

Sustainability is even more crucial for sanitation: piped sewerage is costly and its benefits even less perceived by individuals.

Considerations for governments

Consider an **iterative assessment** of service levels, technical options and expenditures on one side and future demand, tariffs and affordability and willingness to pay on the other (at least for projects above a critical size). Consider carefully the optimal level of service provision to capitalise on economies of scale and scope.

Price setting should allow achieving **“sustainable” cost recovery**. The rules should be clear and predictable. Set optimal mix between price cap and rate of return regulation to provide incentives to improve efficiency, to invest and to balance needs of users. Favour water conservation. Consider also the alternative tools available to achieve the objectives of equity and water conservation. Tackle in parallel prices for wastewater treatment and raw water abstraction.

Where affordability is low and infrastructure needs large, subsidies remain necessary, especially in rural areas and for sanitation.

Clarify subsidy levels, time span, nature (connection / consumption) and the targeting process (depending on local settings, consider appropriate mix of targeting through household surveys, geographic targeting, self-selection and subsidies to technologies used by the poor). When envisaged, the setting of cross-subsidies should allow for changes in the user base.

Be aware that the **choice of technology** will lock-in the profile of service provision for years. It should match technical considerations and affordability. There is a wide range of choices, especially for sanitation: different levels of on site, conventional and simplified sewerage. Diversification of service provision may help ensure financial sustainability while serving pro-poor objective. Allow for easy upgrading of facilities so that users can climb up the technology scale.

Tools and practices

OECD FEASIBLE model:

www.oecd.org/document/56/0,3343,full_r2649_34335_33719928_1_1_1_1_0_0.html

Pricing water resources and water and sanitation services, OECD (2009):

www.oecd.org/water

DANCEE toolkit for assessing willingness to pay, affordability and political acceptability:

www.miljoestyrelsen.dk/udgiv/publications/2002/87-7972-228-8/pdf/87-7972-217-2.pdf

Chile subsidy programme:

www.gpoba.org/docs/07ch2.pdf

Adaptation of technology in Brazil and Bolivia,

see Trémolet (2006):

<http://siteresources.worldbank.org/INTWSS/Resources/WN11.pdf>

Deciding on public or private provision of infrastructure services

Principle 3

Apply tailor-made model of private sector involvement.

The allocation of risk between private parties and the public sector will be largely determined by the chosen model of private sector involvement, including the allocation of responsibilities. The selection of a particular model and an associated allocation of risk should be based upon an assessment of the public interest.

Sector-specific features

High risk sector (cumulates commercial, political, contractual, legal, regulatory and reputational risks). Inadequate risk sharing arrangements are at the heart of past disputes.

Very heterogeneous private sector, with different comparative advantages and capacities to bear risks.

Wide disparities in initial conditions across countries and regions that generate different needs and risk allocation structure.

Public interest has various aspects: access (including for disadvantaged groups), environmental sustainability, health and safety, community choice and organisation. The various aspects may not be easy to reconcile (consumer interest may vary widely across connected and unconnected).

Considerations for governments

The menu of contracts is extensive, allowing for diverse risk sharing across parties:

smaller projects, reduced risk transfer (lease, management), greenfield contracts for bulk facilities and joint ventures. The structure of incentives changes accordingly. Risk allocation should be driven by an assessment of the party best able to manage it so as to ensure value for money and sustainability of partnerships. Success of a model can only be assessed in the long run when sustainability and adaptation to changes can be proved. The bidding process cannot achieve alone the relevant risk allocation, which is shaped by the dynamics of the relationship.

Build on the **strengths of respective private actors**. Tap on small-scale providers' capacity to reach out to poor customers in smaller cities, peri-urban and remote areas. Examine how joint ventures between international companies and local actors can help alleviate the foreign exchange risk and support technology transfer. Examine the opportunities in innovative decentralised approaches to water and sanitation services to complement traditional centralised systems and adapt to the new challenges raised by climate change (their use should be assessed against the loss of economies of scale they may induce).

If private sector participation is envisaged, **consider a stepped approach**: strengthen commercial functions and information system through service or management contracts first and develop greater understanding between the private and public sector for a more motivated choice. Provided that competition is preserved, such an approach can facilitate transfer of know-how, help develop a better understanding of the state of water systems and help strengthen public sector performance.

Consider carefully **the roles for different levels of government** and the co-ordination mechanisms across different actors.

Tools and practices

Blending of private sector and public money (Colombia, Malaysia, Peru).

Affermage in Senegal (risk allocation and incentive setting): www.afd.fr/jahia/Jahia/lang/en/home/publications/documentsdetraivail/pid/1378

Alternative ways of providing water and sanitation: emerging options and their policy implications. OECD (2009): www.oecd.org/water

Involving the small-scale: Mauritania delegated management model in small towns, contracts between public utility and small-scale providers in Ho Chi Minh City, see Building Partnerships for Development: www.bpd-waterandsanitation.org

Partnership communities and private sector: the Agua Para Todos Partnership (Bolivia): www.bpdws.org/web/w/wwww_134_en.aspx

Stepped approach: EMOS (Chile) contracted out several activities before divestiture. Yerevan water supply going private gradually, see ADB (2008): www.adb.org/Documents/Reports/Yerevan-Water-Supply

Deciding on public or private provision of infrastructure services

Principle 4

Preserve fiscal discipline and transparency.

Fiscal discipline and transparency must be safeguarded, and the potential public finance implications of sharing responsibilities for infrastructure with the private sector fully understood.

Sector-specific features

Payments of fees, subsidies and guarantees that constitute long-term expenditures and contingent liabilities on budget.

Owing to the essential nature of water, government is expected to act as the provider of last resort if operator fails to deliver.

Local management involves sub-national entities (municipalities, utilities).

High transaction costs (numerous transactions, actors and models).

Considerations for governments

Determine what bears on budget: subsidies, extension of network, guarantees, oversight and co-ordination and transaction costs. For the sake of **fiscal transparency and sustainability**, disclose future costs of private sector participation and incorporate them in medium-term budgetary projections and debt sustainability analysis.

Guarantees to attract private sector result in contingent liabilities bearing on fiscal accounts. Consider **adopting clear rules on disclosure of guarantees** (monitoring of the diverse guarantees provided through a register of guarantees, integration of estimated cost in annual budget).

Clarify the **fiscal relationships of governments** with sub-national entities. Clarify the legal basis for sub-sovereign financing.

Encourage building of **capacity, transparency and accountability of sub-national entities**, using incentive mechanisms (linking central transfers to quality of reporting for instance) and information sharing (publication of financial and management information). Encourage monitoring by civil society.

Third party oversight, *e.g.* by parliamentary bodies, may help safeguard the integrity of the process.

Tools and practices

OECD Best Practices for Budget Transparency:
www.oecd.org/gov/budget

IMF recommendations:
Government Guarantees and fiscal risk, IMF, 2005:
www.imf.org/external/np/pp/eng/2005/040105c.pdf

Recommendations by the Camdessus Panel (2003) the Gurría Task Force (2006)

on financing water for all:
www.financingwaterforall.org

Output Based Aid can help clarifying subsidies:
www.gpoba.org

Credit rating of Mexico City: development of a municipal bond market without the backup of sovereign guarantees.

Enhancing the enabling institutional environment

Principle 5

Enabling environment.

A sound and enabling environment for infrastructure investment, which implies high standards of public and corporate governance, transparency and the rule of law, including protection of property and contractual rights, is essential to attract the participation of the private sector.

Sector-specific features

The water and sanitation sector presents high contractual, foreign-exchange and sub-sovereign risks. It generates important political interest and substantial involvement from the international community (international financial institutions and donors).

The quality of water and sanitation governance does not relate only to purely sectoral issues, but also to land tenure, housing security, decentralisation policy, and environmental rights.

Planning and implementation horizons for water and sanitation require long-term consistent policies that extend beyond political horizons and may be made difficult by political instability.

Small-scale business is particularly affected by a burdensome business environment, poor infrastructure and underdeveloped financial systems. The poor bear disproportionately the consequences of poor business environment (in their activity and in their access to basic services).

Considerations for governments

The public sector remains the enabler: the quality of the business climate and of corporate governance depends on a wide range of legislation, administrative and policy practices and on policy coherence.

Clarify and separate between different State roles: political function, administration and operation of service delivery.

With water and sanitation being largely local issues, be mindful of **consistency across central and municipal government** and of institutional continuity.

All tiers of government and public agencies should **respect their commitments** (*i.e.* timely payments of water bills and subsidies).

Better integration of small-scale private actors in the chain of service provision may require some form of official recognition of the legitimacy of their activities. Consider building on the burgeoning oversight by local communities and governments to frame their activities.

Tools and practices

OECD Policy Framework for Investment:
www.oecd.org/daf/investment/pfi

OECD Principles of Corporate Governance:
www.oecd.org/daf/corporate/principles

OECD Guidelines on Corporate Governance of State-owned Enterprises:
www.oecd.org/daf/corporateaffairs/soe

OECD Principles of Regulatory Reform:
www.oecd.org/document/27/0,3343,en_2649_33735_2753254_1_1_1_1,00.html

UNCITRAL Legislative guide:
www.uncitral.org/uncitral/en/uncitral_text/procurement_infrastructure/2001Guide_PFI.html

Water Dialogues are developing in South Africa, Uganda, Brazil, and Philippines to identify the key bottlenecks:
www.waterdialogues.org

Maputo and Bamako licensing of operators by communities, see Building Partnerships for Development:
www.bpd-waterandsanitation.org

Reform of general concession law in Russia:
www.oecd.org/daf/investment/russia

Enhancing the enabling institutional environment

Principle 6

Fight against corruption.

Infrastructure projects should be free from corruption at all levels and in all project phases. Public authorities should take effective measures to ensure public and private sector integrity and accountability and establish appropriate procedures to deter, detect and sanction corruption.

Sector-specific features

Large-scale constructions involve large financial flows.

Numerous transactions and stakeholders in service provision.

Complexity of organisation, including patchwork of public agencies and administrative rules.

Important political involvement in projects.

Monopolistic sector with limited cost-recovery constitute strong incentives for collusion.

Opacity and asymmetry of information.

High demand and human need dimension. Water rationing and interruptions provide important corruption opportunities.

Importance of informal sector.

Considerations for governments

Develop a **holistic approach to corruption**: supply as well as demand side, small-scale and large, public and private, financiers and providers. Involve the users to report on service quality and behaviours.

Consider sending **strong political signal**: adhere to international anti-corruption conventions (OECD and UN Conventions), induce institutional reforms (procurement, judiciary), set a structure of disincentives and strengthen monitoring and enforcement.

Reduce incentives: address corruption explicitly in the cooperation framework, define performance targets and outputs, develop reporting and information disclosure (including on cases of corruption), introduce opportunities for challenges and reviews, and allow for a mutually beneficial cooperation. Reduce incidence of transaction, gain from each transaction and increase probability of detection and penalty. Establish credible threats.

Encourage communication on anti-corruption policies throughout levels of government and training programmes to the staff.

Be aware and **mitigate potential negative impacts** of the fight against corruption: the costs related to proliferation of controls and institutions and the impacts on the poorest. Tackle corruption in an open, inclusive and equitable manner by suggesting alternatives so as to avoid negative consequences of removing illegal connections, closing below-standard facilities.

Tools and practices

OECD Anti-Bribery Convention:

www.oecd.org/daf/nocorruption/convention

United Nations Convention against Corruption:

www.unodc.org/unodc/en/corruption/index.html

Transparency International Global Corruption Report 2008:

www.transparency.org/publications/gcr

Kecamatan Development Project, Indonesia:

Empowerment of community:
www.worldbank.org/id/kdp

Veracruz, Mexico: Political leadership and transparency programmes:

www.unglobalcompact.org/docs/issues_doc/7.7/case_stories/BAC_2D.2.pdf

Public Utility Board in

Singapore: Development of codes of conduct and staff training:
www.pub.gov.sg

Enhancing the enabling institutional environment

Principle 7

Create a competitive environment.

The benefits of private sector participation in infrastructure are enhanced by efforts to create a competitive environment, including by subjecting activities to appropriate commercial pressures, dismantling unnecessary barriers to entry and implementing and enforcing adequate competition laws.

Sector-specific features

Limited possibility for direct competition owing to inelastic demand and supply, high fixed costs, high transport costs and economies of scale. Vertical integration often justified by internalisation of externalities and cross-subsidisation.

Some opportunities for competition for the market (through competitive bidding) and benchmark competition. However, competition for the market can be circumvented through strategic renegotiations and monopolies hidden by complex share-holding arrangements.

Limited competition in post-contract phase, once the operator is selected and acquires a competitive advantage owing to inside knowledge of the sector. Consequently, opportunities for competition essentially lie at the frontier: for network extension, new household connections in small towns and peri-urban areas.

Considerations for governments

Show strong political leadership: transparency and early signaling of policy will help **level the playing field**. Develop technical expertise: careful review of bidding and consideration of history of practices elsewhere.

Be aware of the trade-offs in contract award: risk borne by investors vs. probability of renegotiations and length of contract (which provides incentive to invest in maintenance) vs. more frequent competitive tendering.

Exclusivity awarded to enable cross-subsidies and attract investors **can have counter-productive consequences**. Consider opening market and encouraging alternative providers, where network and household connections expansion is slow, to speed up provision to the poor at better price.

Ensure that **small-scale providers are not excluded** from the market while avoiding cartelisation among them.

Develop benchmark competition by **comparing performance across water providers** and releasing the information to the public.

Consider **streamlining the operational practices and legal form** under which the public water providers operate to level the playing field with private competitors and develop benchmarking. Administration and regulation procedures should be consistent across the whole sector to encourage fair comparison and competition.

Tools and practices

OECD Global Forum on Competition:

www.oecd.org/competition

OECD Guidelines on Corporate Governance of State-owned Enterprises:

www.oecd.org/daf/corporateaffairs/soe

Benchmark competition:

- with the best performing company with associated reward (England, OFWAT: www.ofwat.gov.uk)
- with a model company (Chile: www.oecd.org/dataoecd/4/58/2083795.pdf)
- across city zones (Manila, Jakarta)
- against performance set in a contract (Senegal: www.afd.fr)

Public information systems:

- across utilities (PERPAMSI, Indonesia: www.perpamsi.org)
- across municipalities (Kostra, Norway: www.ssb.no/kostra and Canada: www.nationalbenchmarking.ca)

Enhancing the enabling institutional environment

Principle 8

Facilitate access to financial market.

Access to capital markets to fund operations is essential to private sector participants. Restrictions in access to local markets and obstacles to international capital movements should, taking into account macroeconomic policy considerations, be phased out.

Sector-specific features

Specific needs owing to long-term, stable but low return investments and sub-national management.

Perceived as a high-risk sector by investors and lenders (cumulates commercial, political, contractual, legal, regulatory and reputational risks).

The water and sanitation sector presents high contractual, foreign-exchange, sub-sovereign and political risks.

Uncertainty of revenue streams (unstable tariffs policies and difficult bill collection).

Some small-scale projects may not generate interest from the banking sector owing to high transaction costs and to limited credit worthiness of small-scale operators.

Considerations for governments

Improve financial status of sub-national entities: support and facilitate the drafting of long-term strategy and the development of stable revenue streams as prerequisites to attract long-term financing.

Take stock of the **financing tools and guarantee schemes** available and used elsewhere. Assess what can be adapted locally, taking into account the costs associated with risk mitigation tools.

Facilitate access of local small-scale business to financing: facilitate assistance to overcome the challenge of preparing bankable projects, support linkages with bigger operators and promote a more SME friendly banking and financial system.

Tools and practices

Recommendations by the Camdessus Panel (2003) the Gurría Task Force (2006) on financing water for all:
www.financingwaterforall.org

OECD Financial Planning Tool for Water Utilities:
www.oecd.org/dataoecd/14/23/39859631.doc

Sub-national tools:

- Guaranteed municipal bonds (Johannesburg 2004, India: \$2.9bn in 10yrs).
- Development of credit rating of sub-sovereign entities and connection of local and international credit rating agencies to lower costs (Mexico).
- ADB Sub-sovereign facilities in local currency:
www.adb.org/Documents/Policies/Local-Currency-Loan-Product/local-currency-loan-product.pdf
- PPIAF Sub-National Development Technical Assistance Programme (www.ppiaf.org/snta)
- Cities Alliance Municipal Finance Task Force (www.mftf.org)

Matching supply and demand for long-term instruments, the potential of infrastructure funds based on pension funds:

OECD/IOPS Global Forum on Private Pensions: www.oecd.org/daf/fin
Pan African Infrastructure Development Fund: www.harith.co.za

Blending financing sources:
Zambia Devolution Trust Fund, Colombia, Malaysia, Peru.

Public/Private Developers:
InfraCo (www.infraco.com)
IFC Ventures (<http://ifcventuresinc.com>)

Revolving mutual funds (US):
www.epa.gov

Goals, strategies and capacities at all levels

Principle 9

Consultation with stakeholders.

Public authorities should ensure adequate consultation with end-users and other stakeholders including prior to the initiation of an infrastructure project.

Sector-specific features

Water and sanitation are segmented sectors that involve multiple stakeholders (users, sector employees, different layers of government and public agencies, communities, donors, private sector, NGOs and environmental associations).

Water is a human need with important externalities. Its management is highly politicised.

The sector may involve the construction of particularly large physical infrastructure with potentially important impact on local communities (dams) and of facilities that may generate local controversies (treatment plants).

Labour intensive sector.

Important cross-jurisdictional and cross-country dimension.

Important vertical and horizontal co-ordination dimension across levels of government.

Considerations for governments

Facilitate **clear understanding of roles and responsibilities of all stakeholders**, notably through the creation of capacity and space for dialogue. Develop co-ordination mechanisms. Consider ways of meaningfully involving weaker communities.

Involve the employees and their representatives in project development.

Develop consumer trust and awareness through information campaigns on public policies and disclosure on key project information and expected outcomes. Communicate on the reasons for unpopular decisions or actions.

Public consultation should be developed according to the principles of **clear focus, representation and transparency** and follow published standard procedures. It requires time and resources and should therefore be organised strategically at important stages of policy making and preferably start at the early stage of the projects. Consultation should involve explicit feedback from the public authority.

Consider **greater involvement of civil society** (NGOs, consumer groups) in protecting consumer rights, monitoring service provision and determining model of utility management. Consider providing adequate training.

Tools and practices

Aarhus Convention:

www.unece.org/env/pp/

AccountAbility: Partnership Governance and Accountability Framework: www.accountability21.net

OECD handbook on information, consultation and public participation in policy-making: www.oecd.org/gov

Releasing key project information: a project summary template
Partnerships Victoria Disclosure Policy: www.partnerships.vic.gov.au

ILO Declaration on Fundamental Principles and Rights at Work: www.ilo.org/declaration

PPIAF toolkit on labour issues in infrastructure reform: www.ppiaf.org/LaborToolkit/toolkit.html

WaterAid / TearFund Advocacy Guide: www.wateraid.org/documents/psp_advocacy_guide_tf_and_wa.pdf

Providing space for dialogue: Water dialogues in South Africa, Uganda, Brazil, and Philippines: www.waterdialogues.org

Consumer consultation: membership in administrative board of water company (Senegal), in regulatory board (Water Watch Group, Zambia), in consumer consultative committee (UK). Establishment of State-Citizen Water Councils in Mexico.

Phnom Penn workforce incentive model: www.adb.org/water/actions/CAM/PPW/SA.asp

Goals, strategies and capacities at all levels

Principle 10

Empower authorities responsible for privately-operated infrastructure projects.

Authorities responsible for privately-operated infrastructure projects should have the capacity to manage the commercial processes involved and to partner on an equal basis with their private sector counterparts.

Sector-specific features

Decentralised systems (transport costly compared to unit value) and local management. The search for more efficient, accountable and flexible provision of public services has been a driving force behind a greater devolution of powers to local entities. However, the recent decentralisation process has not always been followed by building of human and financial capacities.

Important consequences of the decentralised nature of water management for capacity building, monitoring and performance management.

Importance of horizontal co-operation across municipalities to achieve economies of scale.

High political interferences in multi-layer system.

Considerations for governments

When considering sub-national assignment of responsibility, **be cautious of potential trade-off** between capacities, economies of scale and costs, resource management, co-ordination on one hand and proximity, community empowerment, accountability, efficiency on the other.

Consider **careful allocation of roles and responsibilities** across different authorities – including to the PPP unit when relevant – taking into account existing capacity gaps. Allocation of resources should be predictable and commensurate with responsibilities.

Encourage training: from central government to sub-national entities, across municipalities (notably through forums, internet platforms, exchange of staff to share practices). Focus training on the key elements of partnership (respective roles and responsibilities of parties throughout the project, tariff setting and adjustments, performance monitoring, handling disputes and informing and communicating with the public). Introduce performance management mechanisms to help building capacities. Be aware that capacity building takes time and commitment.

Preserve consistency across government policies: reduction of overlapping responsibilities, strengthening of co-ordination mechanisms across government levels (through consultative fora, inter-ministerial committees), coherence across different policy areas (tax policy should not contradict tariff policy for instance).

Monitor and evaluate performance.

Developing performance indicators for local governments can facilitate exchange of information and promote good practices.

Tools and practices

The Water Boards in the Netherlands, see OECD Territorial Review. Competitive cities in the global economy: www.oecd.org/gov/regional-development/randstad

Bolivia 1994 Popular Participation Law, see Asian Development Bank: www.adb.org/participation/toolkit-methods-approaches.asp

Reform of the institutional setting in Mauritania, regarding supervision and regulation of 350 small independent operators in small towns

Integrated Sanitation budget line in Uganda to empower districts in the area of sanitation, see OECD (2009). Financing strategies for water supply and sanitation: www.oecd.org/water

Training support structures: South Africa Treasury and PPP unit (www.ppp.gov.za), UK Public Private partnerships Programme of Local Government Association (www.4ps.gov.uk), Partnerships UK (www.partnershipsuk.org.uk), Partnerships Victoria in Australia (www.partnerships.vic.gov.au)

Information sharing and learning: Kostra, Norway (www.ssb.no/kostra)

Goals, strategies and capacities at all levels

Principle 11

Clear and broadly understood objectives and strategies.

Strategies for private sector participation in infrastructure need to be understood, and objectives shared, throughout all levels of government and in all relevant parts of the public administration.

Sector-specific features

Segmented sector: oversight responsibilities for water resource management and service provision are split horizontally between different Ministries, and vertically between national, regional and local authorities. Consequently, responsibility is often diluted and allocation of responsibilities is unclear.

Important bearing on social (education, health, gender, settlements) and environmental policies.

Water and sanitation governance issues are not purely sectoral, they relate to land tenure, housing security, decentralisation policy, and environmental rights.

Water governance and reforms involve many objectives that may seem difficult to reconcile (service obligation, social equity, economic efficiency, resource preservation).

Considerations for governments

Institutional arrangements vary greatly across countries. In that context, consider **strengthening common understanding across levels of government** of respective responsibilities for overall policy and objectives setting and for the enforcement of policy framework. This involves clear definition of objectives, means and resources to achieve the objectives and of compliance mechanisms.

The objectives in terms of universal service and services to the poor should be clarified, as well as the expectations in terms of network extension, prices and level of services.

Ensure consistency across the main development programs and with general policy. Water and sanitation infrastructure development in particular has to be addressed as part of an integrated urban programme that tackles housing, tenure and relocation (when relevant). This can be done through multi-annual planning for water strategies and enhanced inter-ministerial co-ordination on water issues.

Involve different levels of government in **structured negotiations** over planning process, implementation and monitoring.

Channel efforts of the many involved actors towards **main development programme** (including NGOs, donors, diverse private actors).

Tools and practices

Setting of a steering committee across the different ministries in charge of water to ensure co-ordination in Ethiopia

Sector Wide Approach to Planning in Uganda

Singapore: on line codes of practice www.pub.gov.sg

OECD Promoting Pro-Poor Growth: Infrastructure: www.oecd.org/dac/poverty

Goals, strategies and capacities at all levels

Principle 12

Mechanisms for cross-jurisdictional co-operation.

Mechanisms for cross-jurisdictional co-operation, including at the regional level, may have to be established.

Sector-specific features

Due to the high cost of transporting water (relative to its unit value), large regional networks are not as common as in the electricity sector. Water systems tend to be decentralized and operated under local jurisdiction.

Importance of cross-border management of water issues owing to scarcity of resource, uneven distribution, and the widespread consequences of mismanagement of resource (such as pollution, for instance).

Spatial and functional organisation of river basins and watersheds does not necessarily correspond to administrative boundaries.

Mechanisms to enforce poverty reduction across municipalities (cross-subsidisation).

Considerations for governments

Adopt and implement the principles of Integrated Water Resource Management (IWRM) that promote a holistic approach to management of water resources.

Enhance inter-municipal co-operation and develop specific incentives.

Consider tools for vertical collaboration (between central government and sub-national levels such as municipalities), such as contracts.

Develop regional co-operation. Consider trans-border agreements.

Envisage dispute settlement mechanisms to frame resolution of conflicts that cross-jurisdictional co-operation may trigger.

Tools and practices

On IWRM, see Global Water Partnership: www.gwpforum.org

Coordination across municipalities:

Inter-communalité in France, see www.intercommunalites.com and OECD Economic survey of France 2007: www.oecd.org/eco/surveys

Common legislative framework for municipalities in Portugal, see OECD Territorial review of Portugal (2008): www.oecd.org/gov/regionaldevelopment/portugal

Water Boards in the Netherlands (see OECD Territorial Review. Competitive cities in the global economy: www.oecd.org/gov/competitivecities)

Contract as a tool for vertical collaboration and cross-border regional governance, see OECD Territorial Review 2006: www.oecd.org/gov/regional

Nile Basin Initiative:

Setting up of regional institutions to manage jointly water resources: www.nilebasin.org

Making the public-private co-operation work

Principle 13

Establish communication and consultation with private sector.

To optimise the involvement of the private sector, public authorities should communicate clearly the objectives of their infrastructure policies and they should put in place mechanisms for consultations between the public and private partners regarding these objectives as well as individual projects.

Sector-specific features

Contracts cannot be fully comprehensive:

- long-term arrangements,
- shock-prone environment (currency devaluation),
- uncertainty on the quality of baseline data (on the real state of water systems, the customer base and the revenue flows).

Multi-stakeholder dialogue: multi-level responsible public authorities, multiplicity of private actors, key role of users and communities.

Important social, political and environmental repercussions.

Considerations for governments

The basis for the relations between the responsible public authorities and the private operator is the formalised contractual arrangement.

The non-contractual relations are important elements of the communication between the public and private actors but need formalization if they predominate.

Consider including in contract **clauses and mechanisms to frame the discussions on future issues** (including on dealing with the consequences of inadequate information) as well as formal dispute resolution mechanisms. Starting the discussion early when challenges arise and before conflicts escalate may help.

Consider developing **one-stop shops for private operators to ensure coordinated communication of responsible public authorities.** This may involve the development of a dedicated website to inform the private sector and perform basic tasks (licensing for instance).

Create **capacity and space for dialogue between the public and private sector.**

The communication channels may differ across actors, depending on the existence of business association for instance and whether the sector is informal. Determine which actors are legitimate interlocutors. Promote association of independent providers, remaining careful of preventing cartelisation.

Engage the private actors to formulate their requirements and constraints for **mutual understanding and better appropriateness** of contracts.

Promote dialogue across operators to encourage sharing of good practices and capacity building.

Tools and practices

Global Water Operators Partnerships Alliance:

www.unsgab.org/hapi/wops

Municipal sanitation platform in Durban coordinating private activities:

www.bpdwaterandsanitation.org/web/w/www_37_en.aspx

The affermage contract for the urban water of Senegal includes a performance contract between SONES (asset holding company) and SDE (private operator) that brings the partners together every 6 months for review.

Efforts by responsible public authorities to reach out to small-scale providers:

First National Conference on Small Scale Water Service Providers conducted in August 2007 in the Philippines and subsequent formation of National Waterworks Association of the Philippines (NAWASAP), see annual report of the National Water Resources Board:

www.nwrp.gov.ph/Uploads/annualreport2007.pdf

APWO of Uganda: Association of small private providers that aims to coordinate action and generate a common voice:

www.oecd.org/dataoecd/50/25/37787617.ppt

Making the public-private co-operation work

Principle 14

Full disclosure of project related information.

There should be full disclosure of all project-relevant information between public authorities and their private partners, including the state of pre-existing infrastructure, performance standards and penalties in the case of non-compliance. The principle of due diligence must be upheld.

Sector-specific features

Water and sanitation facilities are mainly underground and difficult to appraise. In the past, underestimated state of disarray of infrastructure has led to many controversies.

Asymmetry of information and limited reversibility of infrastructure projects in the short run.

The flow of information is made difficult by multi-jurisdictions dimension.

Importance of information disclosure to fight corruption, facilitate a better understanding of all parts and make public policy clear in a sensitive area.

Considerations for governments

Invest time and capacity in the due diligence process.

When information gaps have been identified, **concentrate on improving data quality overtime**. Involve all stakeholders in data improvement strategy.

Provided the uncertainty on the state of infrastructure, consider **updating the baseline data used to develop the business plan before the contract starts**.

Adopting performance-based contractual arrangements with performance targets defined in terms of improvement rates rather than absolute level can help reduce data requirement. Consider **focusing the monitoring on a limited set of key indicators** (for which there is agreement on computing methodology).

Clarify expectations and constraints faced by the partners.

Tools and practices

OECD Principles of Corporate Governance on disclosure and transparency expected from the corporation:

www.oecd.org/daf/corporate/principles

OECD Guidelines for Performance Based Contracts

between Municipalities and Water Utilities: www.oecd.org/env/water/performancebasedcontracts

The challenges of implementing a performance-based contract in Yerevan (Armenia):

www.oecd.org/dataoecd/25/22/40572658.pdf

IWA set of monitoring indicators

Partnerships Victoria Practitioners' Guide.

Sections on confidentiality and disclosure:

www.partnerships.vic.gov.au

Best practices in procurement and contract publishing requirements from the Victorian Government Purchasing Board:

www.vgpb.vic.gov.au/

Making the public-private co-operation work

Principle 15

Fair, non-discriminatory and transparent awarding of contracts.

The awarding of infrastructure contracts or concessions should be designed to guarantee procedural fairness, non-discrimination and transparency.

Sector-specific features

Contract design and bidding process are key elements of success of projects.

Importance of the credibility of the deal, of the responsible public authorities and of the reputation of the private actor for a sustainable cooperation.

The sector involves long-term relationships that need to be grounded in sound contractual arrangements and processes.

The consequences of rigged contract awarding may be important (higher prices and lower investment levels) and may fall disproportionately on the poor.

Considerations for governments

In the contract award process:

- **Ensure clarity and transparency of rules of game** for all stakeholders, including clearly communicated evaluation criteria.
- **Maximise the opportunity for competition.** Minimize opportunities for collusion and for future renegotiations by carefully selecting the characteristics of process (number of operators and their co-ordination) and the award criteria.
- **Favour simple award criteria** to help readability of bids and focus on quantity, quality and prices of services to be provided.

Bid evaluation is a critical element to assess financial and technical capacity of parties to deliver the project. Past track record can be an indication of performance but should not be too narrowly defined as to exclude smaller firms or limit excessively competition. Consider writing an evaluation report describing the financial propositions of bidders, service delivery propositions, construction proposals, potential risks to government, technical and financial capacities of parties, flexibility of proposal to accommodate changes.

In the design of contract:

- Be aware of the tensions between detailed contract and its flexibility. In setting the deal characteristics, **be aware of the consequences** on incentives for private sector: duration (trade-off private sector commitment vs. competition and risk borne by the private actor / by government), investment vs. performance obligations, allocation of risks, cost of capital determination, valuation of concession assets, pro-poor objectives.
- **Provide for regulatory elements** (price cap vs. rate of return, guidelines for adjustment in tariffs, social tariffs) and dispute settlement principles (performance bond, contingencies for renegotiation, recourse to international arbitration, permanent review panels and permanent dispute panels) in the contract.
- **Check that the contract and related documents and processes are consistent with the legal framework.** If the law requires changes that will affect the contract, it should be done before the contract enters into force.

Tools and practices

Kessides (2004) for a discussion of different types of regulation and their respective merits:

<http://go.worldbank.org/IGoW1RPX70>

OECD (2006).

Concessions:

www.oecd.org/dataoecd/36/6/35967639.pdf

Partnerships Victoria:

www.partnerships.vic.gov.au

Making the public-private co-operation work

Principle 16

Output/performance-based contracts.

The formal agreement between authorities and private sector participants should be specified in terms of verifiable infrastructure services to be provided to the public on the basis of output or performance-based specifications. It should contain provision regarding responsibilities and risk allocation in the case of unforeseen events.

Sector-specific features

Infrastructure gaps remain substantial and level of access low in most developing countries.

Operational performance of the water sector remains heterogeneous and weak across countries, but also within countries.

High level of public money allocated to infrastructure development and subsidies requires accountability.

Focus on output (such as people provided with access) rather than inputs would allow to dispassionate the debate on ownership of operators.

Considerations for governments

The contract should **define precisely the scope of the project** (objectives to be achieved, rights, obligations and responsibilities of all parties), set non-contradictory targets and avoid over-regulation (combination of performance targets and investment obligation for instance) and contradiction with the regulatory framework.

Set realistic deadlines, as the results might not materialise in the very short-term. The contract should specify the framework for negotiations; include clauses and mechanisms to frame discussions on future issues and formal dispute resolution procedures.

Regulate and monitor outputs rather than inputs. Avoid strict technical service specifications as it restricts options and might disadvantage the poor. Relaxing some technical standards (*i.e.* pipe diameters, gradient and depth) may allow the development of cheaper, pro-poor systems and provide a pragmatic and more effective approach to achieve the MDGs, should they reflect users' demand.

Develop monitoring processes and promote reporting of economic, environmental, and social performance. Improve data availability and quality over time.

Identify and focus on a small number of key indicators (clear, easy to measure) to lower the cost of information provision. These will typically include indicators of progress in outcomes, of service quality, of efficiency and of financial performance. Targets can be specified in terms of tangible improvements if uncertainty exists over actual levels. Definition and methodology to compute the indicators should be agreed between the parties.

Assessment and monitoring of performance can build on feedback from civil society (users, NGO and communities).

Tools and practices

OECD Guidelines for Performance Based Contracts between Municipalities and Water Utilities:

www.oecd.org/env/water/performancebasedcontracts

The use of a performance-based contract in Yerevan (Armenia):

www.oecd.org/dataoecd/25/22/40572658.pdf

Performance targets embedded in the affermage contract for the urban water of Senegal (in terms of leakage reduction, improvement in bill collection): www.afd.fr

Output Based Aid schemes in Kenya:

www.wsp.org/UserFiles/file/67200752513_MicrofinancePolicyNoteAf.pdf

Investment plans and service level, see OECD (2009)

Managing water for all: an OECD perspective on pricing and financing

Simplified sewerage in Latin America: www.irc.nl/page/8193

Global Reporting Initiative: www.globalreporting.org

Citizen report cards in Bangalore:

www.swedishwaterhouse.se/swh/resources/20051010171233CommunityVoiceasAnAidtoAccThampi.pdf

Making the public-private co-operation work

Principle 17

Competent, well-resourced and independent regulatory bodies.

Regulation of infrastructure services needs to be entrusted to specialised public authorities that are competent, well resourced and shielded from undue influence by the parties to infrastructure contracts.

Sector-specific features

Monopolistic sector, long-term incomplete contracts and multi-stakeholders dialogue. High occurrence of renegotiations.

Necessity of a holistic approach to preserve well being of users, while safeguarding environment, from water extraction to wastewater discharge.

Quality issues are very prominent (quality of water, pollution).

Complexity of pricing policy with potentially conflicting objectives: cost recovery, economic efficiency, equity and affordability.

Key importance of maintenance in a capital-intensive sector.

Challenges magnified by asymmetry of information, limited credibility of recently established regulatory bodies, importance of small-scale informal providers for which national regulatory tools are often ill-suited and diversity of private actors in a decentralised setting.

Considerations for governments

There should be a **clear separation between commercial and regulatory functions** of the State. Regulatory bodies should follow principles of good regulation, in particular: clarity, practicality and focus (on water quality, environmental regulation, economic regulation to oversee monopolistic market, monitoring and consumer representation).

Establishing the regulatory body prior to reform can support building-up stability and credibility. Resource capacity should be commensurate with mandate. Roles and responsibilities may evolve as capacity and credibility develop. Consider alternatives such as market-based instruments, information approaches, self-regulation, regulation by contract and contracting out of specific functions that may complement actions of regulatory bodies. Efforts must be made to ensure consistency with other regulations and policies.

Predictability, transparency, consistency and clarity of rules foster both independence of decision and accountability of regulatory bodies. It involves: adopting clear rules for decision making (*i.e.* on tariffs setting and review), disclosing information on decisions and procedures, specifying recourse mechanisms, submitting to judicial reviews and introducing review clauses. Reporting obligation towards a publicly elected parliament may strengthen accountability. Regulatory impact analysis can help assess the likely benefits, costs and effects of regulations. Effective enforcement involves **credible and applicable sanction mechanism**.

Decentralisation may improve responsiveness to local necessities but may generate co-ordination problems. Similarly, a multi-sector agency can help share fixed costs, limited capacities; build expertise in cross-cutting issues; and better resist capture by specific interests but may lose sector-related capacity. The decision will depend on country capacities and size. In any case, consider **strengthening co-ordination among regulatory authorities and levels of government** and reducing overlapping of responsibilities.

Acknowledge diversity of private actors and identify the challenges they raise for regulation. A comprehensive regulation may be costly and have adverse impact on small-scale and decentralised activities. Administrative simplification involves reducing number and forms of procedures and better information on regulatory principles and lines of responsibility. A number of tools exist depending on contexts: one-stop shops, on-line licensing and business services. Regulation and oversight of decentralised systems might be best provided by local communities and governments. Engagement strategies of small-scale entrepreneurs include licensing, municipal delegated management models and partnerships with utilities.

Tools and practices

OECD Guiding Principles for Regulatory Quality and Performance:
www.oecd.org/dataoecd/19/51/37318586.pdf

OECD Key issues and recommendations on consumer protection:
www.oecd.org/dataoecd/53/0/14636760.pdf

OECD Guidelines on Corporate Governance of State-owned Enterprises:
www.oecd.org/daf/corporateaffairs/soe

World Bank Handbook for evaluating infrastructure regulatory systems:
<http://rru.worldbank.org/Toolkits/InfrastructureRegulation>

The Guaranteed Standards Scheme, see OFWAT, UK:
www.ofwat.gov.uk

Smart Regulation in Canada: training, public consultation, monitoring and review:
www.regulation.gc.ca

On-line business services:
Canada: www.bizpal.ca
UK: www.businesslink.gov.uk

Regulation of small-scale providers:
Incentive package developed by NWASCO, Zambia:
www.nwasco.org.zm

Regulation of prices and MOU with tanker operator association by PURC, Ghana: www.purc.com.gh

Regulatory impact analysis in Ireland: www.betterregulation.ie

Regional regulatory initiatives to promote capacity building and harmonisation through development of guidelines and sharing of good practices: South Asian Forum for Infrastructure Regulation (<http://safirasia.org>), African Forum for Utility Regulators (www.afurnet.org)

Making the public-private co-operation work

Principle 18

Allowing for good faith, transparent and non-discriminatory renegotiations.

Occasional renegotiations are inevitable in long-term partnerships, but they should be conducted in good faith, in a transparent and non-discriminatory manner.

Sector-specific features

Long-term, complex contracts that cannot be comprehensive and cover all potential events.

Uncertainty on the quality of baseline data (on the real state of water systems, the customer base and the revenue flows).

Occurrence of important external shocks – exchange rate devaluation, increased price of inputs – has put stress on several partnerships in the past.

Over the long run, legitimate changes in policies and objectives.

Considerations for governments

The constantly changing environment that countries face (due to external and internal factors such as population growth, migration to urban areas, evolution of poverty, institutional development), and the long-term commitment to a specific technology that infrastructure projects represent call for **building some flexibility to adapt to new conditions into contractual arrangements**. It may involve including rights to modify specifications (at a cost) in the contract. In any case, providing for clear rules to frame the discussions on future issues in contractual arrangements will help to manage the flexibility and avoid conflict escalation.

Some basic principles can help avoid unnecessary renegotiations:

- **Be aware of the trade-off** between the risk borne by investors and the probability of renegotiations: less renegotiation when award based on higher transfer fee vs. lowest tariff and rate of return vs. price cap.
- **Less renegotiation** when a credible regulatory framework is in place (prior to reforms): existence of regulatory body and regulatory framework embedded in law (rather than decree or contract).
- **Less renegotiation** when regulation is by objectives (on performance indicators) rather than by means (investments) as it gives more flexibility (notably in terms of technology and strategies) to reach the objectives. For similar reasons avoid multiplicity of criteria (potentially contradictory and leverage for renegotiation) and using criteria likely to be modified soon (tariffs).
- **Avoid making renegotiations too easy** and allowing possibility to default cheaply. Use of performance bonds, step-in rights, renegotiation fees and contractual stipulations specifying under what circumstances revisions shall be considered can limit the occurrence of renegotiations and improve their efficiency.
- **Develop credible and realistic terms of reference** and contract specifications and avoid changes in policy orientation (adding additional provisions – such as delivery to the poor – after award).

Tools and practices

OECD (2006). Concessions:

www.oecd.org/dataoecd/36/6/35967639.pdf

Variation clauses under the UK Private Finance Initiative:

www.hm-treasury.gov.uk/documents/public_private_partnerships

Making the public-private co-operation work

Principle 19

Setting dispute resolution mechanisms.

Dispute resolution mechanisms should be in place through which disputes arising at any point in the lifetime of an infrastructure project can be handled in a timely and impartial manner.

Sector-specific features

There have been some cases of high profile disputes with foreign investors related to water and sanitation projects in recent years.

Highly politicised disputes that generate social unrest and may threaten the political power.

Disputes are amplified in context of weak institutional, regulatory and legal framework, where contract enforcement is an issue.

The poor pay disproportionately the consequences of delayed investments and inaction that may arise from long-lasting disputes.

Considerations for governments

Consider including in contract **clauses and mechanisms to frame the discussions on future issues** (including on dealing with the consequences of inadequate information), as well as **dispute resolution mechanisms** (performance bond, contingencies for renegotiation, recourse to international arbitration). Clarify remedies available to private investors in case of dispute.

Anticipate disputes and prefer amicable settlements to arbitration. This can be encouraged by creating contractual disputes panels, which meet and discuss the contract regularly. Starting the discussion early when challenges arise and before conflicts escalate may help.

Bilateral investment treaties allow foreign investors to have access to international arbitration (through the International Centre for Settlement of Investment Disputes - ICSID - for instance) even though the contract may provide for local courts jurisdiction. **Inform local authorities of international obligations and of national consequences of breach of international obligations.**

Be aware of **trade-offs between detailed contracts and flexibility** to adapt to changing environment.

Tools and practices

World Bank Alternative Dispute Resolution Manual:

<http://rru.worldbank.org/Toolkits/AlternativeDisputeResolution>

The lease contract for Yerevan water identifies the major conflict resolution mechanisms (including recourse to a facilitator with a substantive knowledge in water management who proposes solutions and arbitration by the London Court of International Arbitration):

www.oecd.org/dataoecd/25/22/40572658.pdf

Expert panels (Chile):

www.ppiaf.org/documents/gridlines/22RegDisp.pdf

ICSID cases and documents:

www.worldbank.org/icsid

Encouraging responsible business conduct

Principle 20

Responsible business conduct.

Private sector participants in infrastructure should observe commonly agreed principles and standards for responsible business conduct.

Sector-specific features

Water is a basic human need, with important economic, social, environmental and political repercussions.

Important interaction with users.

Water and sanitation are key elements of development policies and generate important political interest.

Labour intensive industry.

Responsible business conduct is of particular importance in weak governance environment (where the needs are usually greatest).

Diversity of private actors involved and of the key issues in terms of business conduct: large, concentrated operators have significant negotiating power, especially in weak governance zones; small-scale operators may enjoy limited knowledge of standards; the water activities of big users may escape public scrutiny as being a side (even if sometimes substantial) share of their activities; financial groups may overlook the specificities of water as a basic need and environmental good in risk assessment.

Considerations for governments

Support the use of principles and standards of responsible business conduct as reflected in intergovernmental instruments such as the OECD *Guidelines for Multinational Enterprises* and the ILO *Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy*.

Governments can be supported in their efforts through **appropriate partnerships with business organisations** to strengthen the institutional and regulatory framework, especially in weak governance zones.

Consider providing **capacity building to small-scale operators**.

Tools and practices

OECD Guidelines for Multinational Enterprises:

www.oecd.org/daf/investment/guidelines

OECD Risk Awareness Tool for Multinational Enterprises in Weak Governance Zones:

www.oecd.org/daf/investment/wgz

ILO MNE Declaration:

www.ilo.org/public/english/employment/multi/index.htm

UN Global Compact Principles:

www.unglobalcompact.org/AboutTheGC/TheTenPrinciples

UN Principles for Responsible Investment (UN PRI) and the water specific set of principles:

www.unpri.org

Equator Principles:

www.equator-principles.com

Aquafed Code of Ethics:

www.aquafed.org/pdf/AquaFed_Code_of_Ethics_2005-07-11.pdf

SNS REAAL Water Fund

(assessment of project bankability includes sustainability analysis):

www.snsam.nl/index.asp?NID=7636

Encouraging responsible business conduct

Principle 21

Good faith and commitment.

Private enterprises should participate in infrastructure projects in good faith and with a commitment to fulfil their commitments.

Sector-specific features

Long-term partnerships in a vital sector.

Important information asymmetry and little reversibility over the short-run increase the risk of capture of responsible public authorities by specific interest.

Very specific knowledge and technology.

Important political and social repercussions of failures.

The private sector faces an important reputational risk.

Considerations for governments

The government should clearly communicate its expectations:

- In terms of local capacity building and transfer and diffusion of technologies and know-how.
- In terms of timely, reliable and relevant information disclosure on activities, structure, financial situation and performance (including participating with good faith and commitment to due diligence processes).

Private enterprises should be made aware of dispute resolution mechanisms provided for in the contract and of the existence of any investment protection agreement. In case of dispute, consider first alternative dispute resolution mechanisms, such as conciliation and mediation.

In any case, good faith and goodwill of the parties to co-operate and find mutually beneficial solutions will remain crucial.

Tools and practices

OECD Principles of Corporate Governance:

www.oecd.org/daf/corporate/principles

OECD Guidelines for Multinational Enterprises:

www.oecd.org/daf/investment/guidelines

OECD Policy Framework for Investment (chapter 7):

www.oecd.org/daf/investment/pfi

Encouraging responsible business conduct

Principle 22

Fight against corruption.

Private sector participants, their subcontractors and representatives should not resort to bribery and other irregular practices to obtain contracts, gain control over assets or win favours, nor should they accept to be party to such practices in the course of their infrastructure operations.

Sector-specific features

Multi-stakeholder projects, multi-layer administration and important information asymmetry.

Monopolistic sector with limited competition and in some cases low tariffs that do not allow for cost-recovery constitute strong incentives for collusion.

Some large-scale constructions involve large financial flows.

High demand and human need dimension. Water rationing and interruptions provide important corruption opportunities.

Importance of informal sector.

Greater needs are in countries where governance is weak and local governments lack capacity.

Considerations for governments

Promote public commitment by business to integrity and to abstain from improper involvement in local political activities. Encourage joint public campaigns to promote integrity.

Promote greater transparency around transactions through competitive bidding and publication of contracts.

Encourage companies to communicate on anti-corruption policies and internal management systems to the staff, including through training programmes.

Encourage integrity throughout the supply chain through transparent sub-contracting mechanisms and communication on anti-corruption policies to sub-contractors.

Encourage companies to limit incentives: particular attention to activities where contacts with consumers are high (connections, repairs), appropriate remuneration of staff.

Staff and consumers should be given opportunities to report on reprehensible behaviours. Consider whistle-blower protection.

Credible threats such as forgoing recourse to international arbitration if corruption is proved – see ICSID award in World Duty Free Company Limited v Kenya case – or including anti-bribery provisions in financial institutions due diligence requirements (disclosure of past violations of corruption laws, adoption of anti-bribery programmes) can provide strong incentives to refrain from corrupt practices.

Tools and practices

OECD Anti-Bribery Convention:
www.oecd.org/daf/nocorruption/convention

OECD Guidelines for Multinational Enterprises:
www.oecd.org/daf/investment/guidelines

OECD Risk Awareness Tool for Multinational enterprises in Weak Governance Zones:
www.oecd.org/daf/investment/wgz

Transparency International Integrity Pact:
www.transparency.org/global_priorities/public_contracting/integrity_pacts

TI Business Principles for Countering Bribery:
www.transparency.org/global_priorities/private_sector/business_principles

World Bank Institute Business Fighting Corruption website and guide for collective action:
<http://info.worldbank.org/etools/antic>

Pact for Promoting Integrity and Fighting Corruption in Brazil:
www.unglobalcompact.org/docs/issues_doc/7.7/case_stories/BAC_2D.1.pdf

ICC Rules of Conduct and Recommendations for Combating Extortion and Bribery:
www.iccwbo.org/policy/anticorruption

Agreements based on TI Business Principles in Colombia (www.waterintegritynetwork.net) and Argentina (www.transparency.org)

OPIC requirements to allocate funding:
www.opic.gov/pubs/handbooks/guides/documents/opicanticorruptionhandbook0906.pdf

Coalitions to fight corruption:
CIPE www.cipe.org/programs/corruption
WIN www.waterintegritynetwork.net

Encouraging responsible business conduct

Principle 23

Communication with the consumers.

Private sector participants should contribute to strategies for communicating and consulting with the general public, including vis-à-vis consumers, affected communities and corporate stakeholders, with a view to developing mutual acceptance and understanding of the objectives of the parties involved.

Sector-specific features

Ultimate objective for infrastructure development and management is universal access and sustainable use of water resources.

Consequences for health of better water and sanitation practices are important.

Water is a basic need and generates high social unrest if not perceived to be delivered adequately.

Consumer trust is a key element of reform, notably in support to pricing policy.

Considerations for governments

Engage companies in the monitoring and communication process when put in place by the public agency/regulator.

Encourage companies to be responsive to clients' claims and provide transparent and effective procedures to address consumer complaints.

Involve companies in the awareness campaigns (to promote hygiene for instance).

Encourage companies to communicate to consumers the rational for price increases (when relevant) and other major changes in service delivery and be in line with service quality and users needs.

Tools and practices

OECD Key issues and recommendations on consumer protection:

www.oecd.org/dataoecd/53/0/14636760.pdf

OECD handbook on information, consultation and public participation in policy-making: www.oecd.org/gov

OECD Recommendation on Common Approaches to the Environment and Officially Supported Export Credits:

www.oecd.org/dataoecd/26/33/21684464.pdf

SDE in Senegal launches surveys to assess consumers' satisfaction and provides free phone number for customers' information.

Encouraging responsible business conduct

Principle 24

Awareness and responsibility for the social consequences of actions.

Private sector participants in the provision of vital services to communities need to be mindful of the consequences of their actions for those communities and work, together with public authorities, to avoid and mitigate socially unacceptable outcomes.

Sector-specific features

Important economic, social, environmental and political repercussions.

Consequences for the poor: tariff setting, design of new investments, choice of technology, connection policy, water quality.

Consequences for the environment: water conservation and system management (maintenance), treatment of effluents.

Considerations for governments

Promote assessment and discussions of the consequences for the poor of the technology choices, tariff setting policy, investment planning.

Engage private actors in initiatives aimed at mapping the location of the poor and better understanding of demand.

Promote contribution to sustainable development by evaluating the full impact of activities on environment and continuously seeking to improve environmental performance. Favour the adoption of basic principles of water demand management, such as water conservation, adoption of metering (for efficiency, water conservation and greater empowerment of consumers), reduction of leaks through improved maintenance and technical measures and re-use of water when water scarcity calls for it.

Promote adoption of environmental management standards such as ISO 14001, and of ISO/TC 224 guidelines for service activities relating to drinking water and wastewater systems.

Promote awareness on the consequences for employees of transfer of ownership: share information before and after transfer on measures affecting the employees and cooperate with the employee representatives to forge the common values of the company.

Promote reporting of economic, environmental, and social performance. Encourage companies to engage with their financiers over the environmental and social consequences of their decisions and actions.

Tools and practices

Global Reporting Initiative:
www.globalreporting.org

ILO Declaration on Fundamental Principles and Rights at Work:
www.ilo.org/declaration

Norms ISO: www.iso.org

United Nations Guidelines for Consumer Protection:
www.un.org/esa/sustdev/sdissues/consumption/cpp1225.htm

The CEO Water Mandate:
www.unglobalcompact.org/Issues/Environment/Water_sustainability/index.html

The Manila Water Sustainability Report:
www.manilawater.com/files/MWC_SusDevo7.pdf

The Guaranteed Standards Scheme, OFWAT, UK:
www.ofwat.gov.uk

UK Protection of Employment Regulations (TUPE):
www.berr.gov.uk/employment/trade-unionrights/tupe/page16289.html

Pro-poor strategies in Manila (Manila Water) and Soweto (JOWAM)

Management of resource scarcity: Namibia and Singapore reduction in unaccounted for water and reused water technology

Many countries have sought the involvement of the private sector to upgrade and develop their water and sanitation infrastructure and improve the efficiency of water systems. However, high capital intensity, large initial outlays, long pay-back periods, immobility of assets and low rates of return generate high risks. These factors, when combined with poor initial information and a weak investment environment, constitute important constraints on private sector participation in water and sanitation infrastructure.

Recognising this, the OECD has developed practical guidance, building on the *OECD Principles for Private Sector Participation in Infrastructure*, to help governments and other stakeholders to assess and manage the implications of involving private actors in the financing, development and management of water and sanitation infrastructure. The resulting OECD Checklist for Public Action provides a coherent catalogue of policy directions for consideration by governments, including appropriate allocation of roles, risks and responsibilities, framework conditions and contractual arrangements necessary to make the best of private sector participation and harness more effectively the capacities of all stakeholders.

This booklet reproduces the checklist extracted from the publication, *Private Sector Participation in Water Infrastructure: OECD Checklist for Public Action*. Find out more at www.oecd.org/daf/investment/water.