



For a beneficial private sector participation in the water and sanitation sector, lessons learnt from Latin American country experience

Mexico, 4-5 September 2008

Jointly organised by the Mexican Institute of Water Technology (IMTA) and the Investment Committee of the Organisation for Economic Co-operation and Development

SUMMARY REPORT

On 4-5 September 2008, the Mexican Institute of Water Technology and the Organisation for Economic Co-operation and Development held a joint Expert Meeting entitled “*For a beneficial private sector participation in the water and sanitation sector, lessons learnt from Latin American country experience*”. The expert meeting aimed to advance the debate on private sector participation in the water and sanitation sector by providing a forum to discuss and better define the key elements of beneficial partnerships. After the NEPAD/OECD Investment Initiative roundtable organized in Lusaka in November 2007 and the ADB/OECD expert meeting held in Manila in March 2008, the IMTA/OECD expert meeting was the third opportunity to discuss the draft OECD guidance on private sector participation in the water and sanitation sector, building on the experience of Latin American countries. The discussions focussed on recent experiences and trends in selected Latin American countries, the conducive institutional and regulatory framework, the respective roles and responsibilities of partners, their contributions in financing the sector and the conditions for improved transparency and accountability. Participants also provided specific comments on the OECD work. The report below summarises the key points made during the discussions.

- ***Recent experiences and trends***

Experiences with private participation in the water and sanitation sector have been very diverse in Latin America. Some have been considered to be successful, others not. It is difficult to make a global assessment of these experiences: diversity of local conditions - including financial, macroeconomic, and social -, the size of projects, the state of development of regulatory frameworks, the quality of the institutions, the technical capacity and independence of regulatory bodies etc ... all contribute to explain the outcomes of partnerships with the private sector. In addition, the interconnection of factors and the absence of sound baseline data complicate the identification of specific aspects of the various partnerships and the assessment of performance and outcomes.

The difficulties encountered by some concession contracts with large multinational companies – that led in some cases to cancellations - were due to a range of problems, such as incomplete initial sustainability assessments (including ill-defined objectives and deficient risk assessment), badly designed tender processes and contractual arrangements in a context of adverse macroeconomic conditions and inadequate regulatory frameworks. These difficulties have had and continue to have important repercussions, including on-going disputes under international arbitration and a redefinition of the modalities of private participation in the sector.

The positive experience of Chile was however highlighted. Participants also mentioned the potential of partnerships with community members, including the cooperation between the users and the municipality in Puerto Cortes (Honduras), the Saltillo mixed concession (Mexico) and the development of urban cooperatives in several countries of the region. Participants also discussed the importance of exploring innovative solutions that build on local initiative and capacity, including the potential merits of franchising, i.e. local businesses using proven management processes and operational standards developed by more experienced companies.

Some participants however pointed out the risks that the new developments of decentralised systems may involve: on the one hand, smaller, decentralised systems may favour greater community involvement and complement traditional forms of provision where coverage is still insufficient; on the other hand, they may lead to significant losses in economies of scale, challenge regulation and control (of water quality for instance), impede the application of cross-subsidies and, in some instances, generate greater risks of corruption.

Private participation in the water and sanitation sector has also triggered important shifts in the focus of public policies, by drawing stronger attention to efficiency of service provision, quality of service, sector organisation, regulation and the need for greater community involvement in planning and definition of objectives.

Finally, participants were of the view that governments should conduct a thorough assessment of the activities that would benefit from private sector participation (considering that public sector provision can also be efficient), clarify objectives for both the public and private sectors, allocate adequately the risks across partners and ensure continuous monitoring and assessment of results. In addition, the chosen model of private participation needs to be coherent with the economic and social context of the country and based on political and social consensus.

- ***Institutional and regulatory framework***

In most Latin American countries, the water and sanitation regulatory framework is poor. It is often complex and imported from abroad without adaptation to local needs. It also often lacks a technical basis and does not clearly specify the incentive and sanction mechanisms. Participants highlighted that the lack of an adequate regulatory framework has had significant negative consequences, such as poor performance of service providers (be they public or private).

Participants also highlighted the benefits of a regulation based on law, compared to regulation by contract, in particular when the private sector is involved. Regulation based on law has the advantages of greater public exposure, diffusion and transparency

(notably through parliamentary debates). By contrast, contracts may be confined to a smaller group of informed people.

It was widely acknowledged by participants that a sound institutional framework contributes to improving certainty, limiting arbitrary decisions and increasing credibility of the system, and ultimately leads to more efficient service provision. Establishing a high quality regulatory framework requires political will and great technical skills – involving engineers, lawyers and economists. This necessitates time and progressive improvements.

Developing the appropriate institutions also requires establishing a good information system that notably corrects the information asymmetries between the provider and the regulator. Lack of information hampers efficient regulation and prevents policy makers and regulators from setting appropriate and reachable goals for the sector, in turn undermining population's trust in public administration.

Some participants raised the issue of pragmatism: what to do in the short-term with incomplete regulatory frameworks and the subsequent spreading of auto-regulation? Another issue was whether the regulatory framework should be the same for all or differentiated between public and private actors. In general, participants were in favour of a single regulator, regardless of the ownership of the operator. Other participants highlighted the need to align regulation in the water sector with other government priorities, such as resource conservation and health objectives.

- ***Roles and responsibilities***

Participants identified governments' excessive handing-over of their responsibilities as a major cause of failure in public-private partnerships. Government should remain the enabler and is, de facto, responsible for the bulk of investment in the sector. This involves establishing a high quality institutional and regulatory framework and a commitment that all, including the poor, be provided with adequate water and sanitation services. Some participants also highlighted the role that governments can have in promoting the development of innovative forms of service provision.

There is no ideal allocation of roles across levels of government. It depends, among others, on local conditions, capacities and inherited structures. Separation of roles - between service provision, supervision, regulation and policy making - remains however crucial, as does the existence of coordination mechanisms and effective communication channels. Participants expressed the view that capacity building at different levels of government is very important, but that in many countries this has not been put into practice.

The discussion also addressed the specific roles that regulators should play – which include controlling service quality, price setting and review, ensuring the long-term sustainability of water provision and sanitation systems, supervising the operators and communicating with the various stakeholders. Some participants highlighted that while formal channels of communication between the regulator and the operators exist; communicating with users and developing users' awareness of sustainable water use and conservation remain great challenges in the region. Consumers' participation in the regulatory process also remains largely ignored. Some participants considered that, in certain circumstances, the private sector can play an important role in ensuring service

coverage to the poor, mentioning the potential of cooperation between the “formal” operator and the local communities in poorly served peri-urban settlements, along the lines developed by microcredit schemes. In this specific case, the operator is in charge of the upstream segment of water provision, i.e. of bringing water to the borders of the peri-urban settlement, while local communities take care of internal distribution of water and of wastewater management. Some participants however questioned the idea that ensuring access for all is the private sector’s duty. Others mentioned risks of “cherry picking” practices.

Participants agreed that population buy-in was an important element of the success of policies and initiatives in the water sector. For example, community participation in the planning phase has proved to contribute to generating confidence and greater ownership.

- ***Financing***

The water sector is often considered risky for private investment, notably because of its vulnerability to external economic and socio-political shocks, inadequate regulation, lack of institutional continuity and insufficient availability of baseline data. Often, however, the key problem is not lack of financial resources (local financing is considered available), but access to it, at competitive levels. Reasons for this include lack of political will – water is rarely among governments’ top priorities. The effective and efficient use of funding is also an issue, particularly at local levels of government where lack of capacity may hinder the implementation of investment plans.

Participants considered that adequate pricing is a strong driver for investment. A stable revenue stream is necessary to allow and reward investment, but also to support the creditworthiness of operators and ultimately ensure an efficient and sustainable provision of water services. Some participants highlighted the fact that in Latin American countries, banks do not accept the revenue of water operators as collateral for loans and often request State guarantees to ensure creditworthiness.

Low water prices are an illusion for the users, since they generally correspond to low quality of the service and the supplied water, with the subsequent health hazards and the need to purchase bottled drinking water. In some countries, the willingness to pay for water provision and sanitation services is low. Moreover, in some countries, for example, Mexico, large sections of the public sector are exempted by law to pay. In such contexts, increasing prices will not necessarily materialise into improved services, as users may simply refuse to pay their bills. Efforts are therefore needed to change the “water culture”. Pricing policies should also be combined with concrete improvements in access conditions, service quality and bill-collection and public support, which may facilitate public acceptance of higher prices.

Some participants emphasized the importance of public financing for sewerage and to ensure that all, including the poorest sections of population, have access to water services. In particular, participants highlighted that it is important to implement focused subsidy mechanisms targeting low income and vulnerable populations, as is the case in Chile. These mechanisms should be based on precise population targeting methodologies. Some also made calls to be realistic and match the available and affordable technology with the need to extend water services to all, and to focus more on effective coverage (which also includes water quality and the safe disposal of used

water). The risk associated with this approach is to generate a perception of discrimination.

- ***Accountability***

Participants were of the view that whatever the model of service provision - private, public, mixed, community-based -, there is a need to strengthen efficiency, accountability and transparency. As of today, the public sector generally remains poorly accountable in terms of performance of service provision, and the general framework for transparency and accountability is often inadequate and hardly geared towards the interest of users.

In particular, current instruments to support disclosure of and access to information on water services (and to prevent its capture by specific interests) are weak. One important challenge is to introduce regulatory accountability and improve the control of purchases and contracts with related companies in order to develop better knowledge of the real costs and facilitate the analysis and supervision of the efficiency of operators.

There is little knowledge among government officials of how best to use the available information. Some efforts are however being made to improve access to relevant information. In some countries, for instance, the consumers are involved in cross-checking the information coming from water operators (public and private). In others, internet is used to publish key information and offer users a platform for discussion.

Participants considered corruption to be a great concern in the water sector. Some participants emphasized that in some countries corruption is prevalent throughout society and strongly impacts on the delivery of services. It was suggested that an important step to prevent corruption is to professionalize the water sector. Other suggestions included independent regulation, better access to information, professionalization of the public administration structure, greater control of electoral funding, and greater supervision, notably of decentralised systems. Participants were also of the view that there is not a one-size-fits-all solution to the problems linked to corruption, but that efficient solutions will depend on multiple factors, such as political will, culture, and institutional framework.

- ***OECD draft Checklist for Public Action***

Participants provided their views and suggestions on the *OECD Checklist for Public Action*. In general, they considered that it can be a useful tool, to the extent that it builds on lessons learnt from recent experiences with private sector participation in the water sector, especially the identification of the causes for success and failure. Among the suggestions for improvement were: to better prioritise the key issues for consideration by governments; to make the format of the *Checklist* more practical; to better address the potential effects of dispute settlement mechanisms; to clarify the issues raised by the diversity of private actors; to reassert that government priorities should be an efficient provision of services to all and the related conducive framework; and to introduce more elements on innovation.