

# Private Sector Participation in the Water Sector: Can It Meet Social and Environmental Needs?

John Thompson *IIED, UK*

The future development, management, protection and use of freshwater resources has become a topic of considerable international debate over the past decade, involving a wide range of actors and numerous milestone events and processes. Most of these place considerable emphasis on market-based instruments and private sector participation as solutions to water scarcity in the 21st Century. At the same time, however, all assert the right of poor people to water and the need to protect freshwater ecosystems. For some, these goals are complementary. For others it is unclear whether the private sector can deliver efficient water services, while also ensuring its equitable and environmentally sustainable use.

### Private sector partnership in the water sector: opportunities and threats

Traditionally, the provision of water supply and sanitation (WSS) services in developing countries has been the responsibility of national and municipal governments. Substantial private sector involvement was considered inappropriate given the public good and basic need characteristics of water and sanitation, and the monopolistic tendencies of the sector. Recently, there has been a large increase in private sector participation (PSP) in the provision of WSS. Between 1990 and 1997, the cumulative private sector capital expenditures in WSS projects in developing countries was \$25 billion, compared with \$297 million in the period 1984–1990. By the end of the 1990s, a total of nearly 140 private sector WSS projects had been implemented in low and middle-income countries, ranging from management contracts to leases, concessions, divestitures and so-called build-operate-own-transfer (BOOT) agreements. Concessions are the most popular form of PSP both in terms of number and size of investment.

One key factor driving the promotion of PSP is the sheer inability of governments to finance the rising capital, operation and maintenance costs of municipal water systems. The World Bank estimates that countries need to invest US\$600 billion in water infrastructure in the next decade alone. In the majority of developing countries, rapidly growing populations, a reduction in assistance for WSS from international agencies and severely constrained public sources of finance have all contributed to making it increasingly difficult for governments to bear the costs of system rehabilitation and expansion. The motivation to embrace PSP has also been driven by a belief that private sector providers may be more efficient than their public sector counterparts, thus reducing costs and increasing service quality and coverage.

For these reasons, municipal governments from Buenos Aires to Jakarta are turning publicly owned systems over to the private sector.

While there is little question that the case for PSP is strong on grounds of

### KEY CHALLENGES:

- A key issue is not how much private sector participation, but rather what form it should take to meet the needs of individual cases, given market conditions, public regulatory capacity etc.
- Given the rapidity of change, it is important that governments, civil society, NGOs and private companies be given assistance to perform their new roles and to work with one another in new contexts
- The social and environmental benefits of water supply and sanitation must be fully incorporated in strategies for service provision
- Community participation should occur in formal decisions on forms of provision, and in the management and operation of provision, including employment generated by informal provision (such as water vendors and neighbourhood resale)

improving economic efficiency and increasing investment rates, concerns have been raised about its ability to address the needs of low-income households or protect the freshwater ecosystem. At a regional level, there are concerns that PSP will not benefit the poorest of developing countries that are less attractive to foreign investors. Indeed, investment so far has been concentrated in Latin America and East Asia with Africa accounting for less than 1% of total investment. Within countries, PSP in WSS tends to be concentrated in urban areas where economies of scale can be realised and potential returns are likely to be higher. Even within urban areas, there are concerns that poorer households may not benefit from any gains in efficiency, either because they live in areas where costs of provision are relatively high or because their demand is relatively low.

There are a multitude of related problems that a private sector provider has to overcome if it is to provide services to poorer areas. Households in expansion areas will often be unwilling to pay connection fees when existing (usually richer) users did not do so when they were first connected to the network. In addition, many households may not be able to finance initial connection costs, even if it is in their longer run financial interest to do so. Finally, the costs of providing a standardised service to some areas, particularly (but not exclusively) in 'illegal' settlements may be prohibitive, as many service providers are now finding out.

Overcoming such obstacles requires innovative solutions that go to the very heart of the provider's relationship with the household. Issues such as tariff structure, service standards and differentiation of services, and local community involvement have to be approached in a new way if the needs of the poor and the environment are to be addressed.

Given the very 'public' nature of the sector, state authorities continue to have an important role to play. Rather than being a manager and provider of services, the government must serve as a regulator and a guarantor of a certain level and quality of provision. The objectives may remain the same, but the instruments have changed. In this respect, PSP may actually place more rather than less demand on effective and capable public authorities. Intervention through incentives requires more skill than intervention through investment. New regulatory capacity is required to deal with these new roles. However, in addition to capacity building, ways of minimising the regulatory burden through the bidding procedures and contractual design are being implemented. But even with the best will in the world, some governments will not be in a position to regulate some of the more comprehensive forms of PSP.

There is little question that inappropriate forms of private sector involvement that are inadequately regulated are unlikely to be of much value to poorer households or any other users, let alone to nature. However, many publicly managed and operated systems have not

themselves been serving poorer households or the environment particularly well. As such, PSP is perhaps best seen as an opportunity to right the balance, rather than as a threat to any existing benefits presently enjoyed by poorer households.

### **Addressing the key issues at Bonn and Johannesburg**

The world's leaders will soon come together to discuss the global freshwater agenda at two key events, first at the International Conference on Freshwater in Bonn in December 2001 and then at the World Summit on Sustainable Development in Johannesburg in June 2002. When they meet, they will need to tackle a number of key issues surrounding private sector participation in the water sector. In addition to the challenges listed overleaf, they should address:

- **Contract design and bidding procedures** – Inadequate and faulty information is an endemic problem in the sector. When it comes to the costs of infrastructure and demand for services in poorer neighbourhoods, information is in particularly short supply. Thus it is important that bidding procedures and contract design allow sufficient flexibility for innovative solutions, without undermining the accountability of the firm.
- **Demand-based provision** – Attention must be paid to the viability and desirability of differentiated forms of service provision (within and between network areas) and alternative systems of management, more closely reflecting the preferences of users, and their willingness and ability to pay for services.
- **Coverage and quality of service must be improved**, particularly for poorer urban areas and small and medium sized towns, leading to a reduction in inequalities of service provision and the relative amounts paid.
- **Security of tenure** – The issue of land tenure is likely to remain a sticking point for poor households. Allowing a private utility to expand services to 'illegal' settlements implies that these settlements are to some extent legitimised. Lending agencies and other influential actors should ensure that these low-income settlements are included in any performance targets specified in the contract.
- **Appropriate service levels** – Service contracts should stipulate the use of high-quality, low-cost, intermediate technologies to expand service coverage to reach low-income areas. ●