Private Sector and Infrastructure

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Private Sector Participation-based Roadmap for Reforms in Water and Sanitation

Political interference and low tariff policies have led to inefficiency and chronic financial weakness of public utilities. The inability of water supply and sanitation (WSS) utilities to maintain and extend services has led typically to situations where in fact subsidized services are denied to the poor who have to rely on more costly and lower quality alternatives. A well-performing utility is a necessary condition for enhancing the economic efficiency of cities and for accelerating the provision of services to low-income areas. However, water utilities in Africa have limited prospects for improving their performance unless they undergo structural reform. Service delivery is not keeping pace with demand, especially for the fast growing number of low-income households living in informal settlements.

Many governments across Africa have recognized the necessity of structural reform to improve water and sanitation services and to extend coverage in fast-growing urban settlements. As noted at the Kampala Conference on the reform of the water and sanitation sector (February 2001): utility reform in Africa is more a matter of “how” than a matter of “if”. More than thirty African countries are either engaged in, or planning reform to increase autonomy and ensure financial viability.

Most reform programs imply the participation of private sector operators through arrangements ranging from management contracts to leasing, concessions, and more rarely, outright asset transfers. In fact, private sector participation has become the method of choice for reforming water utilities and for establishing the conditions for improved efficiency and financial viability.

Private Sector Participation (PSP)-based reforms have generally succeeded in extending and improving services and have in all cases restored a measure of financial viability to systems long starved of the necessary resource to support minimum operation and maintenance (O&M). There are also cases where the drive for reform has faltered, got sidetracked or was abandoned altogether.

A roadmap to get it right the first time

The World Bank, which since the mid-1980s has supported most of the ongoing PSP-based reform of WSS services in Africa, shares the desire for more systematic learning as a way to improve the quality of its advice and the effectiveness of its operations. It felt in particu-
lar that a roadmap structured along the key stages of reform would be a useful format.

The next step was to involve Bank clients and partners. The Dakar Workshop (February 2002) on PSP-based reform of the WSS sector brought together about seventy participants including decision-makers from seventeen African countries, senior staff from development agencies and professional organizations as well as representatives from international private operators. The main objective of the workshop was to prepare a roadmap outline based on the outputs of the workshop’s working groups. The objectives of the roadmap are:

- to develop a shared vision of the conditions for sustainable and socially responsive PSP-WSS services in Africa;
- to offer easy access to the good practices and guiding principles emerging from the experience of African countries;
- to provide practical guidance to planning, implementing and sustaining PSP-based reforms; and
- to facilitate coordinated action by donors.

### Initiating reforms

There is no standard approach, each country has to develop its own. Learning from other country experiences needs a good understanding of commonalities (e.g. lack of resources for investment, lack of regulatory tradition and capacity) and differences (e.g. legal systems especially between Anglophone and Francophone Africa).

Designing a successful PSP transaction is essentially about understanding risks, trying to reduce them and make sure that they align with the competence and capacity required to manage them. PSP is not an end in itself but a means to get better services to more people. PSP in Africa has to be put in the context of strategies to reduce poverty. WSS reforms should be justified in terms of their impact on services to the poor. Early on, the proponents of reform should develop advocacy based on information on the current situation and on the implications for the status quo in the face of fast growing urban settlements.

The enhanced lease has emerged as the option of choice in African reform. The evolution of this model has been driven by efforts to redistribute risks between the operator, the Asset Holding Company (AHC) and the government. The trend has been:

(i) to specify output rather than input targets for key areas of improvements;
(ii) to grant greater autonomy to the operator in the planning and execution of capital expenditures needed to bring early improvements in services provision; and
(iii) to guarantee the availability of related financing, usually from external sources often on concessional terms.

Reforms have to lead to financial viability and long-term financial autonomy through internal cash generation. One of the roles of the AHC under the lease model is to provide a consolidated balance sheet for the urban WSS sector. The short-term financial viability (covering O&M) of water supply systems to be established as autonomous entities should be assessed at the planning stage, i.e. before undertaking the related institutional restructuring.

Tariff adjustments to achieve at least short-term financial autonomy and enabling legislation and institutional restructuring should be introduced before PSP. If the required tariff increases are too steep, operational subsidies need to be secured as part of PSP during the transition to cost recovery tariffs.

### Allocation of responsibilities

Allocation of responsibilities among public sector actors involved in the reform needs to be clear and credible. This issue is of particular importance if reform involves:

- transfers of responsibilities: e.g., from the municipal to central government or among central ministries; or
- the establishment of new agencies and an independent regulator.

The planning and implementation of reform has to be closely coordinated with the preparation of external financing. In most cases, the feasibility of reform depends on external funding either for investment or for needed rehabilitation and early improvements, and in some cases for retrenchments and operational subsidies during the transition to cost recovery tariffs. The involvement of external partners brings added credibility and can broaden interest from potential bidders.

### Key steps in initiating reforms

The first step in implementing reforms includes a strategic assessment of the WSS sector. The scope of issues to be covered include:

- legal and institutional framework and capacity;
- resources, constraints;
- performance;
- financial situation, debt; and
- demand.

The outcome of the assessment should include:

- medium and long-term capacity requirements;
- choice of institutional options;
- roadmap for transition; and
- critical risk factors.

The political will to carry out reform and to support its objectives has to be clearly expressed and manifested at the highest political level, usually through a cabinet
decision and a Letter of Sector Policy.

The Establishment of a sector Task Force (TF) with proper authority and competence is needed. Its work program includes the launching of coordinated studies and surveys enabling the completion of information related to: asset conditions, operations, HR, finances, and demand/market for services. Additionally, studies under the TF’s authority will include the preparation of an investment program, development of a financial model, review of the level and structure of tariffs, HR redeployment and a retrenchment program, and the development of a special program for extending services to the poor.

The TF will also organize specialized working groups in line with the reform’s objectives, hire and collaborate closely with transaction advisors, develop and implement a transition plan within the existing institution as well as a communication and consultation strategy.

The development of the financial model for the sector is a critical element of the preparation and the reform. The purpose of the financial model is to map a path to financial autonomy. In the initiation phase, the financial model will serve to develop the financing plan and to assess the need for tariff adjustments. In the subsequent phases, the financial model will serve in bid evaluation and for fine-tuning and periodic renegotiation of tariffs.

Broad consultation and participation of key constituencies are needed. The related activities include consultations with the public agencies concerned (central and municipal levels), elected representatives (parliament, municipal councils, mayors etc.), civil society (business and industry, customers associations, labor), staff and employees, NGOs, community organizations and programs involved in WSS services to the poor, and small independent service providers.

Emerging experience provides guiding principles in communication consultations and includes: starting early, explaining benefits and comparing with current trends, establishing credibility through reliable information, openness and follow-up, and keeping information flowing (newsletter).

The diagram is a simplified version of an actual case.

Initiating the reform –summary

At the end of the initiating stage it is recommended that the reform addresses the following issues:
- enabling legislation and new institutional structures in place;
- tariff adjustment procedures covering short-term cost recovery level agreed and in place;
- financing plan agreed with external partners including early rehabilitation and transition support;
- PSP option selected and basic parameters of contract defined in line with objectives of reform;
- transition management in place; and
- staff and labor re-deployment program agreed, funded and initiated.

The contract framework for PSP

A WSS lease typically involves a complex web of inter-related legal undertakings:
- the government establishes an asset AHC with which it enters into a performance contract and a development/financing agreement;
- the AHC (jointly with the government in some cases) retains a private operator through a lease/affermage contract;
- further legal instruments cover: (i) the financing plan; (ii) the relationships between the local operator and the strategic partner (usually an international professional WSS services operator); and
- the authority and responsibilities of the independent regulator, where it exists, is established by law. The regulator is not part of the PSP contract but issues licenses both to the AHC as undertaking and to the operator.

The hiring of qualified and reputable transaction advisers is a criti-
The primary competence of the operator relates to managerial and technical know-how as this is the area where risks are to be assumed by it. The transaction should be structured to limit the risk assumed by the operator in areas not under its control or affected by large uncertainties. Contracts that assign broad and undefined risks to the operator will attract few bidders and result in a higher price or attract operators of lower standards.

As world-wide opportunities for operators’ services continue to increase, it is important to market PSP transactions and seek bidders’ interest early.

Early start in establishing and developing capacity of public agencies involved in PSP transactions, in particular the AHC and the regulator, can reduce regulatory risk and build confidence.

Guiding principles

- Start early in building the capacity of public agencies responsible for contract supervision and regulation;
- Define information requirements (as well as certified data) and related responsibilities;
- Foster the participation of local investors and of employees in the capital of the operator;
- Establish process for dealing with changes and adjustments;
- Ensure regular payment of water bills by public sector agencies;
- Establish operator’s authority and procedures for disconnection for non-payment including high-visibility customers;
- Ensure timely execution of capital expenditure under the responsibility of AHC, in particular by delegating project management responsibility to the operator for rehabilitation and distribution.

Contract implementation and regulation

Good contract oversight and monitoring ensure that they remain aligned over time. It requires the willingness and the capacity to respond to changes in circumstances (drought, change in macroeconomic conditions etc.) and at the same time protection from action driven by short-term objectives of either party; e.g. government refusal to grant scheduled tariff adjustments before elections; early termination by the operator after profits realized.

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