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Engaging Local Private Operators in Water Supply and Sanitation Services

Programs to reform urban utilities—and to engage the private sector—have tended to focus on large cities and on transactions with large foreign private operators. This is changing, as smaller towns and cities are growing rapidly in many developing countries. Concurrently, decentralization is shifting responsibility for services from national to smaller entities that often cannot finance and manage them effectively.

Paralleling this trend, new service models in which local private firms contract with local governments or community associations to provide water supply and sanitation (WSS) services have been proposed in smaller urban contexts. We examined how these challenges are being addressed in eight World Bank projects in Cambodia, Colombia, Paraguay, the Philippines, and Uganda. The projects we studied were not complete, but we believe that their preliminary results are worth reporting.

In all five countries, the government has sought public-private partnerships to promote sustainability, increase access to services (particularly for the poor), and, except in Cambodia, strengthen the role of local government. Although private financing has been a goal in several cases, nowhere is it central. Most local private operators are not expected to provide substantial long-term investment. The durations and terms of the contracts we studied vary widely (table 1).

Legal and policy frameworks vary significantly among the countries. Some have laws that clarify responsibilities, decentralize responsibility for operations, establish accountability rules, and encourage private sector participation (PSP). Some have national regulators; others lack effective regulatory frameworks. All five countries have policies that encourage greater access to services by the poor, to the extent consistent with the paramount goal of financial viability. Investment subsidies, particularly those targeting the poor, have played an important role in all cases. However, except for Colombia, subsidies target only communities with a high percentage of poor households—not individual households.

Characteristics of the public and private partners

Except in the Philippines, the lead role in promoting the projects and managing the procurement process has been played by a national water and sanitation authority. Beneficiary communities have been selected on the basis of need and willingness to engage private operators. In most cases, a high level of poverty was also a criterion for eligibility.

In all five countries, most of the potential private partners lacked experience in delivering urban services and the capacity to comply with

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Table 1. Key features of the contract models

Country	Type of contract	Private investment (% of total)	Duration (years)
Cambodia	Design, build, and operate (DBO)	40–50	15
	Design, build, and lease (DBL)	10	15
Colombia	Build, operate, and invest (BOI)	20 (estimated)	16–30
	Build and operate (BO)	None	10–15
Paraguay	Build and operate (BO)	20 (estimated)	10
Philippines	Design, build, and operate (DBO)	None	15
	Operate and maintain, long-term (OML)	None	15
Uganda	Operate and maintain, short-term (OMS)	None	3

World Bank procedures. Initially, informal water supply operators in several countries chose not to compete for the contracts offered. To attract more bids, qualifications in Colombia, Paraguay, and the Philippines were changed to accept experience in network industries other than water. In Paraguay, selected firms were required to hire experienced informal water supply operators as managers. In Uganda, bidders were simply required to score adequately on a general questionnaire.

The entities that signed contracts with local private firms included local governments, water user associations (WUAs), multi-town aggregations, national sector ministries or services, and national financing institutions. In countries where several public sector stakeholders were responsible for various arrangements (investment finance, construction and operating contracts, regulation), multiple contracts were signed. In Uganda and the Philippines, separate contracts were awarded for construction and for operations and maintenance (O&M). In each community in Paraguay, a single private firm signed two contracts: one for construction and another for O&M. In addition, a third agreement was signed between SENASA (the national water and sanitation service) and the WUA regarding subsidies and supervision. The only cases that did not require multiple contracts were in Cambodia, where the central government is responsible for all service development and provision.

Such multi-party arrangements are usually inevitable when responsibility for service provision is decentralized, and a national entity retains responsibility for most of the financing.

All projects have allowed for training, consultation, and promotional activities during the preparation phase, to raise awareness about proposed contracts and to consult with and inform stakeholders, particularly local communities and WUAs. Less emphasis has been placed on providing sustained support to the new partnerships. In several cases, difficulties emerged after contracts were signed—as a result of local officials' lack of commitment or capacity or private firms' lack of professionalism. Ad hoc intervention helped to resolve these situations. More sustained support during the postcontract stage might have prevented such problems.

Contracts and financial arrangements

Contract forms were driven primarily by local factors.

- Uganda chose the short-term operation and maintenance (OMS) model after failed experiments with local water authorities.
- Build, operate, and invest (BOI) contracts in Colombia, and build and operate (BO) contracts in Colombia and Paraguay, were designed to reduce subsidy and construction costs, reduce delays, and promote sustainability. Technical sustainability was enhanced by requiring the contractor responsible for building the water supply system to operate and maintain it over a 10–15 year period. All operating costs, regulatory fees, and taxes were to be paid from tariff revenues.

- In Colombia, the private operator was required to contribute some tariff revenues to a replacement and expansion fund. The requirement is similar to a fee that lease operators pay to asset owners, but the private operator plays an important role in planning and executing investments and expansions both before and after initial construction.
- Cambodia and the Philippines chose design, build, and operate (DBO) and design, build, and lease (DBL) contracts. These enhance technical and financial sustainability, in part by shifting from a supply-driven to a demand-driven approach in systems design and planning.

Full or partial cost recovery featured in all contracts. Full O&M costs are being recovered through user tariffs in all cases. Recovery of capital costs varies depending on the availability of subsidies. To balance cost recovery with the important goal of ensuring access for the poor, subsidies have been provided as grants or as loans on highly concessional terms. As a result, the effect of debt service on tariffs is minimal in five of the eight cases studied. The exceptions are the DBO contracts in Cambodia, where 50 percent of investment is privately financed, and most contracts in the Philippines, where 90 percent of the financing is on-lent by local banks at market rates. These costs perhaps created a barrier to private sector interest, and the Philippines program has not progressed as hoped.

Market size and structure

Most of the communities served by the projects have populations of less than 30,000. In several cases, towns and communities have been grouped to improve economies of scale and attract operator interest. In the multi-community service areas of Colombia and Paraguay, each community is represented in a multi-town authority that contracts with a single private operator. Such contracts attract large, competent bidders, increasing the likelihood of success.

In Cambodia, Uganda, and the first phase of the Paraguay contracts, where common facilities were not practical, an alternative approach has allowed for economies of scale. The selection of operators was organized in lots encompassing several towns or communities. Separate contracts were to be awarded for each town or community. Bidders

were allowed to bid for more than one contract but were required to submit a separate proposal for each. Operators that have won several contracts in this manner have reported substantial economies of scale, without which the contracts would have been less attractive. Operators have no guarantee that all towns in their administrative cluster will renew their contracts, but this uncertainty may provide an added incentive to develop good relationships with the communities and provide high-quality services.

The selection process

Creating effective screening criteria that qualify enough bidders to ensure a competitive process can be a challenge. A prequalification process was used everywhere except Colombia, where bidders submitted eligibility credentials with their proposals. In Cambodia, prequalification criteria were announced in advance, giving bidders time to create strong consortia and thus increasing competition. In Uganda, bidders were required only to qualify against a broad range of criteria. This favored small local firms, and the lenient requirements have proven adequate. Bid bonds were required in all cases, except for OML contracts in the Philippines, which were awarded to WUAs without competition.

Deterrents to bidding have included the lack of concessional finance in the Philippines, and, in Colombia, the high cost of entry and the requirement to qualify as a specialized public service provider.

The most common quantitative bid criterion—applied in Cambodia, Colombia, Paraguay, and the Philippines—was the investment subsidy proposed by the bidder. Other selection criteria were the proposed average tariff, given a fixed subsidy amount (Cambodia); the lowest user connection charge, given a fixed subsidy and a pre-set tariff (Paraguay); a fixed management fee plus variable service fees (Uganda); and the percentage of revenues to be retained by the private operator (Uganda).

Monitoring and regulatory arrangements

All contracts specify service quality and performance targets tailored to local conditions. All operators must submit performance reports to an

oversight entity. In most cases a national entity provides regulation, but usually only with regard to tariff revision. Although ministry-level entities may have nominal responsibility for service quality, they have exercised their authority inconsistently. Even where specialized WSS regulators exist, they rarely provide routine supervision. As a result, except in Cambodia, monitoring and enforcement are generally performed by local contracting parties. In many cases, local monitoring practices need to be strengthened. And, in most cases, the relationship between local and national agencies needs to be clarified.

Lessons learned

We have been able to draw valuable lessons from our examination of these ongoing PSP projects. Prominent among those lessons are the following:

- A well-developed legal framework is not necessary to attract local private operators to WSS projects, especially if little or no investment finance is required and tariffs are adequate to cover O&M.
- Small markets are a challenge. Effective strategies for creating economies of scale are establishing multi-town service areas and allowing bidders to win multiple contracts.
- Small service providers can strengthen PSP if tender processes and contracts allow them to participate.
- The need for qualified bidders must be balanced against the need for enough bidders to ensure real competition. Allowing adequate time for bidders to form partnerships and lenient prequalification criteria have been effective in achieving the necessary balance.
- Training, consultation, and promotional activities are essential during preparation and implementation of contracts with local private operators, as are follow-up consultation and programs to educate users and encourage behavior change. Capacity building during implementation is essential. Continuing education programs and professional associations have provided valuable support for private operators.
- Specific service standards and performance targets are of little use without effective reporting and monitoring mechanisms. Small towns, in particular, lack regulatory frameworks, and the interface between local oversight bodies and national regulatory agencies must be clarified.
- Initial investment subsidies are necessary to ensure that greater numbers of the poor gain access to services and to attract private sector interest. Strategies for mobilizing future investment finance must be developed.

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