Water as a public good vs. water privatization

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THE re-municipalization of the water supply system of Paris at the beginning of this year, until then one of the crown jewels of the French global players in the water sector, could be seen as a signal that the nearly two decade old heated debate on 'Private vs. Public' has turned full circle. But the process of reversing privatization – or to be more precise of Private Sector Participation (PSP) – started already nearly a decade ago, when global water corporations like Suez/Ondeo, Veolia/Vivendi and Thames Water/RWE announced their intention to reduce their engagement in southern countries.

This forced institutions like the World Bank to re-evaluate its privatization strategy for the water sector, conceding that 'under current conditions the private sector will play only a marginal role in financing water infrastructure'.[1] And it opened up room for opportunities for non-governmental, civil organizations and public utilities to develop alternatives to privatization. But first a brief look back on how it began.

The investment requirements in the water sector were the central argument with which private sector participation has been promoted since the early nineties. The expectation was that transnational private utilities would supply capital and modern management. More market, more competition and the entrepreneurial striving for profit would help remove the chronic problems many public utilities are faced with, such as high water loss and insufficient supply. This was the only way – so the *mantra* went – to achieve the Millennium Development Goal, i.e. to cut by half the number of people who do not have access to safe drinking water and appropriate sanitary installations by 2015.

As a preliminary step, profound institutional and political adjustment processes were initiated to create positive investment conditions for private utilities in developing countries. The widespread habit of subsidizing was replaced by the concept of 'cost recovery'. Private investors were encouraged with the help of various risk coverage instruments and by offering low interest loans for Public-Private Partnerships (PPP).

Since then, experience has shown that these projects contributed much less than expected to an improvement of the drinking water supply for the low-income population, and even less so to an increase in the number of sanitary installations. This was even confirmed by a World Bank Report.[2] According to the report, even as privatization results in an improvement in some cases, the basic problems remain: marginalized areas are hardly covered, corruption merely acquires a new shape, and accountability towards the public continues to

1. Water Resources Sector Strategy: Strategic Directions for World Bank Engagement, Draft for Discussion, 25 March 2002, p. 38.

2. Clive Harris, Private Participation in Infrastructure in Developing Countries, World Bank Working Paper No. 5, Washington D.C., April 2003.

remain weak. Frequently, privatization has a negative effect on the poor, as in many cases prices have increased dramatically.

Nevertheless, despite these increases in water charges, corporations have had to concede that the expected easy profits in the water sector are not to be made, the main reason being that costs and returns in most areas of the water sector tend to be diametrically opposed. No wonder that J.F. Talbot, CEO of SAUR International, emphasized that the notion of cost coverage, particularly with regard to low-income groups, is untenable.'[3]

Private investments in many projects remained much smaller than hoped for or even agreed on during negotiations. One of the cases is Manila, where Suez/Ondeo has invested only a quarter of the capital that was originally promised. Instead of being supplemented by additional private resources, the investments continue to be financed by public means: by low interest multi- and bilateral development loans to governments that are then passed on to private implementing agencies.

Thus the politics of privatization creates a dichotomy in the water sector: lucrative areas such as the supply of drinking water for high income groups are transferred to private enterprises; less attractive areas such as squatter settlements, suburbs and rural regions remain with the public sector. This dichotomy corresponds with the dichotomy of public funds for the development of the water sector: on the one hand there is the promotion of the private sector and the minimization of risk for global corporations, and on the other hand there are the alternatives that cannot be privatized, and where increasingly the poor themselves must become self-reliant to balance the lack of funds provided by the public sector.

The multifaceted political, economic and financial problems, however, with which the involved companies are confronted, turned out to be the basic problem confronting the privatization strategy.

* In many countries (Bolivia, South Africa, Indonesia, and the Philippines) there was strong resistance against the water corporations, which, as in Cochabamba, led to a cancellation of the contracts.
* The financial crisis in Asia and the economic crisis in Argentina resulted in grave financial losses, especially for the second ranked of the global players, Suez/Ondeo. Thus the devaluation of the Philippine peso and serious management errors resulted in the cancellation of the contract for Manila (West) which was at one time one of the World Bank's most prestigious projects.
* All three market leaders (Suez, Vivendi and RWE) accumulated large debts as a result of rapid expansion, which became a burden on the shareholder value; Veolia/Vivendi was up for sale after the collapse of the group.

Furthermore, corporate representatives conceded that 'low hanging fruit', low-risk projects that require little investment, have almost all been 'picked'.

Some corporations thus initiated a 'consolidation phase'. A central component of this consolidation was a retreat to – supposedly – secure markets such as the U.S., European countries with a low degree of privatization like Germany, the Eastern European accession countries, or China. Still they claim that they cannot raise the investments necessary to achieve the Millennium Goals without considerable state subsidies and low interest loans. Thus, they are demanding a stronger engagement by the development banks – again with public money.

The World Bank and other multilateral and bilateral financial institutions and donors also became more reserved in their prognoses concerning the participation of the private sector in the countries of the South: 'We were too optimistic concerning the willingness to invest in these countries,' Nemat Safik, Vice President for Infrastructure, conceded, 'despite far-reaching reforms, many countries do not find investors.'

The experiences with privatization and the decreased interest of water corporations also left its mark on a number of governments: 'Privatization has not resolved the water problems for most of the population', is how Olivio Dutra, responsible for urban planning in Lula'da Silva's first Brazilian government, summed it up.

The most obvious conclusion would have been to reorient towards an improvement of public utilities, which had been systematically placed at a disadvantage as opposed to PSP options. However, whenever reforms of public utilities were promoted within the scope of development cooperation, they usually served just as a preparation for privatization, not as a means to improve the functioning of public utilities to remain public. The withdrawal of the private global players could have been an opportunity for development cooperation to once again concentrate on public corporations as the central pillar of water supply and sanitation.

The picture has become much more diverse, mixed and differentiated than let's say a decade ago. Even as the drive for privatization continues, the global players have set their

3. Speech at the World Bank in January 2002, www.worldbank.org/wbi/B-SPAN/docs/SAUR.pdf

sights on a more appealing target: countries with dwindling water supplies and ageing infrastructure, but better economies than developing countries. 'These are the countries that can afford to pay', says James Olson, an US-attorney who specializes in water rights. 'They've got huge infrastructure needs, shrinking water reserves, and money.' Take China. Since 2000, when the country opened up its municipal services to foreign investments, the number of private water utilities has skyrocketed. But as private companies absorb water systems throughout the country, the cost of water has risen precipitously.

At the same time, there are many smaller, regional companies from emerging economies that are driving privatization moves. This is the case in many countries across Latin America and Asia, less so in sub-Saharan Africa.

In principle the World Bank has not relinquished its privatization strategy as can be seen from several strategy papers like the water resources sector strategy (WRSS) adopted in February 2003, or the private sector development strategy (PSDS) from early 2002, which focuses on infrastructure and services.

All the papers have two main ideas in common: (*i*) a widening participation of the private sector in the complete water sector, and (*ii*) a rediscovery of large infrastructure projects. Similar strategy papers and political ideas also emanate from the Asian Development Bank, viz. their Agricultural Sector Programmes. By broadening existing instruments (guarantees, loans, etc.) and by developing new support measures (like output based aid), the World Bank and other development banks are continuing to lower hurdles for participation by corporations in developing countries and make the investment conditions more attractive.

Nevertheless, the World Bank and other donors have become less enthusiastic about private sector participation even though they continue to promote it. Simultaneously, they now promote public water utility reforms, consumer corporations, and other non-private forms of management and ownership.

Additionally, the focus has shifted away from urban water supply and sanitation towards high dams and irrigation, where an increasing proportion of investments of the World Bank now go. Central to the new policy of the World Bank in the water sector is the development of a legal framework for water entitlements, the issuance of such entitlements, and the use of market based mechanisms that permit voluntary adjustment by owners and users to meet temporary or permanent changes in demand. Investments in new or existing hydraulic infrastructure and irrigation projects are considered to provide a greater chance to introduce the basic concepts needed for the issuance of such water entitlements.

Thus, the focus shifts from the privatization of infrastructure or management towards privatization of the water resources itself. And water pricing has become the new magic formula, which has been the base of private sector participation in the 1990s: a higher water price is considered to bring about efficiency, investments, and conservancy, which will also benefit the poor without access to water and sanitation.

Paris water is not the only example for re-municipalization. There are many other prominent cases like Stuttgart and Berlin in Germany, Hamilton in Canada, Buenos Aires in Argentina, Dar Es Salaam in Tanzania, or the move by the federal government of Malaysia, which is in the process of buying all water and waste water infrastructure in the country to develop them with public money. Instead of the so-called Public-Private Partnership there is a new model emerging of Public-Public Partnership (PuPs), where successful and experienced public utilities team up with others to exchange information and experiences on how to improve public service delivery.

Most people involved in this process of reviving public utilities agree that merely a return to the conventional public provision utilities is not solution. Instead, there are several preconditions for success, drawn for example from cases like Porto Alegre and its concept of participatory budgeting. One of these is the participation of workers, employees and unions in the process, extended to participation of users and the public. Another is shifting of resources towards the public sector and the provision of public goods in spite of the precarious financial situation of many municipalities. Both preconditions point to the need and challenge for some fundamental shifts in policy and financial resource management, which are not easy to achieve.

This is not to argue that private sector and industry does not have a role to play. Or that there is no scope to make profit from investments in the water sector. With the right incentives, it is possible to develop and supply the technology needed to make water delivery more cost-effective and environmentally sound. Ultimately both public and private entities will have to work together. The question is: who shall be in the driver's seat? The answer depends on whether water is considered to be a common good and water supply a public responsibility, or not.