What now, World Bank? Or: Lessons learned?

More privatization and large-scale projects or the promotion of public companies and decentralized solutions

by Uwe Hoering, September 2003

The announcement made by the global water corporations Suez/Ondeo, Veolia/Vivendi and Thames Water/RWE concerning their intention to reduce their engagement in Southern countries forces the World Bank to re-evaluate its privatization strategy for the water sector. In its new strategy for the water sector (WRSS) the World Bank concedes: "Under current (!!!- U.H) conditions the private sector will play only a marginal role in financing water infrastructure"[1]. Other multilateral development banks like the Asian Development Bank (ADB) as well as the EU-Water Initiative[2] and the bilateral development cooperation[3] will be equally challenged. Will this make room for opportunities for non-governmental and civil society organizations to influence politics in the water sector?

Private Sector Participation (PSP)

The investment requirement in the water sector is the central argument with which the World Bank and bilateral development financing institutions such as the German Kreditanstalt für Wiederaufbau (KfW) have promoted private sector participation 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 Goals, repeated in Johannesburg 2002, i.e. to cut in half by 2015 the number of people who do not have access to safe drinking water and appropriate sanitary installations.

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

As a result of this, a rapidly growing number of PPP and PSP projects were entered into. They primarily focused on large cities such as Manila, Buenos Aires and Jakarta and on the supply of drinking water, because there the prospect of making a profit seemed best. About half of the large PSP projects in developing countries that came about between 1990 and 1997 were long-term concession contracts.

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[1] Water Resources Sector Strategy: Strategic Directions for World Bank Engagement, Draft for Discussion of March 25, 2002, p38

[2] Long-term development, presented at the WSSD in Johannesburg „Type II-Initiative" intends to make available one billion Euro for investments in the water sector.

[3] It generally holds true for the entire area of infrastructure: Commercial loans for energy projects are on the decline, the number of privately financed transport projects remains far fewer than expected.

Expectations not fulfilled

Since then, experience has shown that these projects contribute much less than expected to the improvement of the drinking water supply for the low-income populations and to the increase of the number of sanitary installations. This was recently confirmed by a World Bank Report[4]. According to the report, privatization results in an improvement in some cases, but the problems known from public utilities remain: Corruption merely acquires a new shape, and accountability towards the public continues to be weakened. Frequently, privatization has a negative effect on the poor, as in many cases prices have increased dramatically.

Despite these increases, corporations 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 these areas tend to be diametrically opposed. And so J.F. Talbot, CEO of SAUR International, had to admit that the notion of cost coverage, particularly with regard to low-income groups, is untenable: “Water pays for water is no longer realistic in developing countries. (...) Service users can’t pay for the level on investments required, not for social projects”[5]

Private investments in many projects remained much smaller than hoped for or even agreed upon during negotiations. A current example is Manila, where Suez/Ondeo has invested only 82 million US Dollars into more efficient private utilities, in other words only a quarter of the means that were originally promised.

Instead of being supplemented by additional private capital, 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 create 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 in 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 risks for global corporations, and on the other hand there are the alternatives that cannot be privatized, and where increasingly the poor must become self-reliant to balance the lack of funds of the public sector though “Self-help”.

The corporations retreat

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

- In many countries (Bolivia, South Africa, Indonesia, the Philippines) there is strong resistance against the water corporations, that often, as in Cochabamba, led to the cancellation of contracts.
- The financial crisis in Asia and the economic crisis in Argentina have 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 manage-

[4] Clive Harris, Private Participation in Infrastructure in Developing Countries, World Bank Working Paper No.5, Washington D.C. April 2003
[5] Speech at the World Bank in January 2002, www.worldbank.org/wbi/B-SPAN/docs/SAUR.pdf

ment errors resulted in the cancellation of the contract for Manila, once one of the World Bank's most prestigious projects.

- All three market leaders (Suez, Vivendi and RWE) have accumulated large debts as a result of rapid expansions in the past years, which are a burden on the shareholder value; Veolia/Vivendi are up for sale after the collapse of the group.
- But smaller companies have problems, too: AquaMundo, a German company, has given up its plans to establish itself in Latin America, SAUR International retreated from Mozambique.

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

Some corporations have thus initiated a ”consolidation phase“. By restructuring, selling sectors which do not belong to the core business, and by concentrating on companies whose profits suffice to make them self-supporting, corporations are trying to reduce their debts and increase their profit.

A central component of this consolidation is the 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.

Box: Fluctuations in currencies – Who carries the risk?

The currency risk was made clear to corporations instantaneously when the boom in speculations came to a sudden halt in 1997 during the Asia Crisis and currencies such as the Philippine Peso lost half of their value within no time at all. Thus calculations based on cost and profit became null and void, as stated in Ondeo’s subsidiary Maynilad’s court case in Manila. Against the fierce resistance of government officials, Maynilad and Bechtel’s subsidiary, Manila Water, not only succeeded in being compensated for value losses incurred by higher tariffs, but in ensuring that tariffs would be adjusted regularly after devaluations. This shifts the risk to consumers – who are thus automatically forced to feel the consequences of globalization in the form of higher prices for water.

The corporations see too many risks in developing countries, due also to devaluations (see Box) and the inability of consumers to pay. Without considerable state subsidies and low-interest loans, they cannot raise the investments necessary to achieve the Millennium Goals. Thus they are demanding a stronger engagement by the development banks. They expect that the ”key role“ (J.F. Talbot) will be played by the World Bank Group, i.e.

- with respect to the mobilization of international funding agencies,
- as policy advisor with respect to the water sector in developing and highly indebted countries,
- as partner, “not as a counterbalance to private sector interests“.

New doubts

The World Bank has also become more reserved in its forecasts 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, concedes, ”despite far-reaching reforms, many countries do not find investors“.

The experiences with privatization and the decreased interest of water corporations has 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 new Brazilian government, sums it up.

During the Third World Water Forum in Kyoto, the proponents of privatization were conspicuously more subdued than they had been at the Second WWF in Den Haag. ”Somebody is overselling the idea of privatizing water“ as a way to reduce poverty, said Richard Aylard, the Director of Thames Water.

Opportunities for the public sector…?

The most obvious conclusion would be to relinquish the current emphasis on private sector participation and the necessary attractive investment conditions. The funds for development cooperation could be concentrated on public corporations, among other things for the expansion of sewage systems and decentralized low-cost, low-technology alternatives for drinking water supply and sewage disposal in low-income districts or rural regions.

Both options have been neglected by the World Bank and Co. in the last few years. Public utilities were systematically placed at a disadvantage as opposed to PSP options. Whenever reforms of public utilities were promoted in the scope of development cooperation, they usually served as a preparation for privatization, such as in La Paz and El Alto in Peru. An employee of the German Kreditanstalt für Wiederaufbau once referred to this kind of cooperation as the „dressing up of the bride“.

Attempts to solve supply problems in rural areas only play a marginal role at the World Bank, even though the large majority of people who do not have access to drinking water and sanitary installations lives there. Thus only about five percent of the means of the water portfolio of the World Bank (1993-2003) flowed into rural programs for water supply and the improvement of sanitary installations.

”Pro-Poor Initiatives“ and an investigation of successful public companies such as in Sao Paulo, Lilongwe (Malawi), Tegucigalpa (Honduras) or Porto Alegre are signs that the World Bank has concluded that global private utilities will hardly contribute to the achievement of the Millennium Goals. The draft of the World Development Report 2004, which focuses on public services, emphasizes the importance of participation to solve problems: ”Some countries have tried to address the problem, especially by involving poor people in service delivery. When this has happened, the results have been impressive. Giving parents voice over their children's education, patients a say over hospital management, making agency budgets transparent--all contribute to improving outcomes in human development.” In other words: “People's Participation” instead of “Private Sector Participation”?

…or more of the same medicine?

There have been a number of signs that the World Bank is not relinquishing its privatization strategy and is looking for ways to adapt it to changed conditions.

Several new strategy papers and action plans which relate either directly or indirectly to the water sector are evidence of this:

- the afore-mentioned *Water Resources Sector Strategy* (WRSS) which was adopted in February 2003,

- the *Private Sector Development Strategy* (PSDS) from early 2002, which focuses on infrastructure and services,
- the *Action Plan for Infrastructure*, which was adopted in July 2003 and explicitly places water as the driving force at the centre of economic growth,
- the *Irrigation and Drainage Business Plan* (IDBP), the strategy for agriculture and food safety.

All papers have two main ideas in common: 1) a broader participation of the private sector in the complete water sector. Thus the Infrastructure action plan is to ”apply new and/or existing instruments more effectively, including a spectrum of public-private partnership“. 2) a dominance of large infrastructure projects[6]. Similar strategy papers and political ideas can be found at the Asian Development Bank, such as their Agricultural Sector Programmes. The German development cooperation regards its PPP-Programs as “ground breaking models“ on an international level – despite vast problems and disappointing results[7].

Opening up agriculture

On the one hand the World Bank, by emphasizing the importance of water supply, water management and irrigation, concedes that the root of the problems in the water sector is not primarily scarce resources, but mismanagement of limited resources, capacities and funds. It is equally valid to shift the focus to agriculture as the greatest consumer and waster.

Yet the core here is again a solution strategy which primarily depends on the participation of private companies and prices for water and services that cover the costs. Distribution and use are to be regulated via the introduction of „water markets“. As a result, grave consequences can already be seen, including:

- agriculture’s further orientation towards export production and cash crops (“high value uses”),
- a ”reallocation from irrigation to urban areas“ due to higher buying power in the cities with their increasing demand.

Alternatives such as rainwater harvesting on the other hand, which have been successfully implemented in many countries for a long time, or measures that reduce the consumption of water ('Demand Side Management') play a minimal role. Generally, they are not very attractive for the participation of private companies.

New dams

In view of the resistance and the negative effects, the World Bank had retreated from participating in financing new dams over a decade ago. Yet in its argumentation it is preparing a turnaround. The World Bank quotes the World Commission on Dams,

[6] For more details see also: Growing Dangers of Service Apartheid: How the World Bank Group’s Private Sector (PSD) Strategy Threatens Infrastructure and Basic Service Provision, www.challengeglobalization.org/html/news_notices/fall2001/fall01PSIRU.pdf; Patrick McCully, Avoiding Solutions, Worsening Problems, A Critique of ”World Bank Water Resources Sector Strategy“, 27 May 2002; Kate Bayliss, David Hall, A PSIRU response to the World Bank’s ”Private Sector Development Strategy: Issues and Options“, PSIRU Reports, October 2001

[7] see Uwe Hoering, “Entwicklungspartnerschaften - Eine wunderbare Freundschaft?“ Weed--Arbeitspapier, Bonn 2003

WCD, and last year's Johannesburg Summit, whose results, recommendations and decisions were partly falsified, in order to support its own position[8]: According to the Bank

- dams bear not only a "high risk" factor but also a "high benefit" factor;
- the need for investments "will probably dictate public-private partnerships in most developing countries[9]";
- hydro-power is under-used in many countries: in Africa only three percent of the potential is used, as opposed to 70 percent in industrialised countries;
- water as an option must be strengthened as a renewable and climate-friendly source of energy and must also be included in the Clean Development Mechanism of the Kyoto Protocol.

The ADB has already gone one step further: A report presented in July recommended the construction of twelve new dams in Burma, Laos and China.

New incentives

By broadening existing instruments (guarantees, loans, etc) and by developing new support measures, the World Bank and other developing banks are continuing to lower hurdles for participation by corporations in developing countries and to make the investment conditions more attractive:

- *Lowering the threshold*: Instead of long-term licenses, the objective is to obtain management contracts that are easier to negotiate, don't require capital and don't pose a long-term risk. Developing banks are hoping for a less complicated entry by private providers and later a conversion into participation forms such as leases or licenses.
- *Mitigating the risks*: Both the Camdessus Report[10] and the International Finance Corporation (IFC), responsible in the World Bank Group for financing private enterprises, contemplate means by which the World Bank or its subsidiaries could take over currency exchange risks and hedge them via the capital market. Moreover, mechanisms such as MIGA, the Multilateral Investment Guarantee Agency in the World Bank Group, continue to be expanded in order to insure political risks or the consequences of wrongful call. Increasingly, take-or-pay contracts are being applied, representing guaranteed sales and profit.
- *Subsidies*: The myth that costs in the water sector can be covered without subsidies has been burst. Presently, the World Bank and Co. are looking for new possibilities for subsidies, which include output-based aid (OBA) through which low-income customers of private licensees are subsidized to counterbalance exaggerated tariff increases. In plain text this means that public funding is rerouted and implemented via the consumer to make private enterprises profitable.
- *The weakening of safeguard policies*: A number of governments - and companies - think that the safeguard policies for World Bank projects to prevent harm to people and environment are exaggerated. Thus it does not come as a surprise that

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[8] Comp. Patrick McCully, Avoiding Solutions, Worsening Problems, A Critique of „World Bank Water Resources Sector Strategy", 27 May, 2002

[9] Action Plan Infrastructure, p16

[10] Financing Water For All, Report of the World Panel on Financing Water Infrastructure, chaired by Michel Camdessus, March 2003

the World Bank refuses to accept the recommendations of the World Commission on Dams (WCD) which go even further. Instead there is a tendency towards a downward ”harmonization“ of the regulations on distributing of funds as institutions such as IFC, MIGA, ADB or OECD place lower demands on social or ecological standards (refer also to the box: Weak regulation).

Weak regulation

John Briscoe, the World Bank's expert on water, refers to regulatory agencies as the second component next to the participation of private corporations. They are necessary to define reliable orientation data, such as tariffs, for participating companies. Furthermore they are to prevent corporations from misusing their monopoly and to make sure that contracts and ecological and social standards are adhered to.

Establishment of such agencies, for which the countries in the South depend on international development institutions, often lags behind the increased participation of private companies. Thus the latest UNDP Human Development Report finds:

”Much more international support is needed to build regulatory capacity in these and other infrastructure areas if the private sector is to do more in achieving the Millennium Development Goals“ (UNDP 2003, 119).

On the other hand J.F.Talbot, CEO of SAUR International, warns of strengthening regulatory bodies too much: ”Unreasonable regulator power and involvement“ would greatly decrease attractiveness for many companies.

- *Fresh money*: Furthermore, the World Bank wants to increase its loans for the water sector in order to balance the decrease in private investments. At the end of January, John Briscoe, the World Bank's water expert, announced that the World Bank portfolio's share of water projects will be increased from presently 16 percent (3.2 billion US dollars) to 24 percent within three or four years: ”It is a big business for us“. The loans given to governments often serve to finance PSP projects and relieve the participating water corporations of the necessity to contribute larger investment sums themselves or to borrow in the capital market. Thus a large number of PSP projects are in the pipeline, for example in countries such as Guinea-Bissau, Angola, Nigeria and Mexico.

More market, more large-scale projects, more opportunities for profit

After a decade of privatization in the water sector of the countries of the South, international development organizations such as the World Bank are obviously in a double-bind: The criticism voiced by privatization opponents is increasingly being confirmed by the experience gained in Buenos Aires, Manila, Jakarta or Nelspruit, South Africa. In parallel, resistance is growing world-wide, also in the seemingly ”safe“ markets such as Europe and North America. Secondly, an essential component of the concept is breaking away, because the desired partners, the global private multi-utility corporations, have not fulfilled the expectations that have been placed in them. This could open new possibilities to demand a stronger consideration of alternatives to privatization that are better suited to solve the problems in the water sector.

Yet instead of rethinking the experiences gathered so far and developing a new orientation, World Bank and Co. seem to be adapting their strategy to changed conditions and expanding it to additional areas of the water sector such as irrigation agriculture and dams. This is not only beneficial for the multi-utility corporations with their large range of activities in various service areas, but also for the construction sector. Furthermore it gives additional private players access to infrastructure and bulk water supply sectors.

This would expand the existing division of the water sector into profitable, risk minimized, privately run segments and the much larger area which continues to be operated by public utilities or by self-help-projects of affected populations. The system of public responsibility and obligation to guarantee water for all and to implement comprehensive sustainable management of this crucial resource would be gradually undermined by privatization, which in fact expropriates the possibilities of public institutions to fulfil these obligations.

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