Strengthening the Capacity and Improving Service Provision in the Water and Sanitation Sector in the CIS Countries

WBI/JVI Workshop
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Session B1

Sector Governance

*Government, Provider, and Consumers working together as Partners*

Jan G. Janssens, WBI
Session outline

- **Sector Governance and Recognized Actors**
  - Mapping stakeholders
  - Unbundling functions
  - Unbundling regulation and back to design issues
  - Looking forward

- **Sector Organization**
  - Between Central, Local Government and Service Provider
  - The concept of ‘Contractualization’
  - The appropriate scale

- **Management Autonomy**
  - A prerequisite for performance
  - Corporatization
  - Balancing external accountabilities
  - Choosing an institutional structure
Recognized Actors

- Newly recognized actors:
  - regional/local government
  - small scale service providers
  - local private sector
  - civil society

- Demanding downward accountability from sub national governments, water management agencies, utilities

- Relations between emerging actors must be governed by the appropriate tools such as legislation and performance contracts
Mapping Stakeholders - Step 1

Users / Customers / Consumers

Domestic – Industrial – Commercial - Agriculture

Organiser / LG

Mayor
Municipal Administration
Regulators
State Authorities

Provider / Operator

Employees
Subcontractors
Suppliers
Financiers
Mapping Stakeholders - Step 2

Customers

Organiser / LG

Essential Public Service

Provider / Operator
Mapping Stakeholders - Step 3

Customers

Organiser / LG

Provider / Operator

Essential Public Service

political
(opposition, NGOs, media, IFIs…)

market
(consumer groups, NGOs, media,…)

commercial
(competition, reputation, ressources)
Unbundling of WSS sector functions

Policy making
Regulation
Asset ownership
Corp. Oversight
Service provision

reform

Policy making
Regulation
Asset ownership
Corp. Oversight
Service provision

always public

public, private, or PPP
Reform of Sector Framework

- Separation of functions is critical first step but insufficient

- Other critical factors include:
  - Financial flows
  - Formalization of responsibilities
  - Mandate and composition of Corporate Oversight Board (Executive Board of Utility)
Other critical factors (1)

Financial flows determine accountability

- **Revenues**: cost recovery from users
- **Financial management**: controlling costs
- **Access to alternative financial sources for investment**
  - Government (central, régional, local)
  - Donors and Multilateral Agencies
  - Commercial Banks
Other critical factors (2)

- Formalization of responsibilities through contracts [“contractualization”]
  - Written contracts
  - Reporting (requires defined, simple and measurable indicators)
  - Enforcement (requires defined and realistic sanctions)
  - Transparency (put contracts, reports, sanctions in public domain)
"Unbundling" Regulation

- Rules
- Instruments
- Entities

'Regulation'
Much greater appreciation for, and progress towards transparent, balanced regulation

- Protect consumers (both present customers and non-connected poor households)
- Promote other social interests
- Protect service providers
- Promote economic efficiency
Regulatory functions

1. Writing the regulatory rules
2. Monitoring: collecting & analyzing information about performance
3. Formally seeking compliance with regulatory rules
4. Applying the rules to yield a binding decision
5. Handling appeals on decisions
6. Enforcing decision if operator does not comply

Rarely are all functions combined in one entity
Back to design issues - 1

- should regulation be performed by central, state, local government agencies?
- agency, contract or both? how much discretion?
- multi-sector “utilities commission” or sectoral?
- combine price regulation with standard-setting?
- Regulation by contract?
regulation, a big concept; but often very pedestrian in practice

need for capacity on all levels, and foremost, appropriate for local conditions

all of this is not the panacea

all the contracts and charters are meaningless unless their spirit is backed by full political commitment

no substitute for policy reform
Looking forward - 1

- The issue is to have sustainable service delivery through viable (public or private) service providers (utilities)
- Focus must be on:
  - **Financial viability**: tariffs, targeted subsidies to close financial gap, access to sub-national financing
  - **Good governance**: separation of roles & responsibilities, accountability and transparency, monitoring performance
- Avoid political interference
  - Encourage political support
  - Escape “stop-go” situations
Looking forward - 2

- With a balanced, pragmatic approach ...
  - The challenge: bring government, regulator, provider on to the same page,
  - Taking the difficult task of reforming public utilities
  - Introducing a change management process
  - How can the private sector help? What can the public sector learn from the private sector to be more efficient/effective?
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1. Performance based intergovernmental transfers
2. Performance based agreements
Contractualization

establishing a **contractual relationship between public entities**, namely state and local authorities, and services providers (public, private or community operators), **in order to empower, and create incentive and accountability structures within, a public utility** thereby improving service delivery and increasing efficiency of operations.
A process?

**Contractualization** (or: “institutionalization”)

is a process that involves the creation and implementation of a chain of contracts and/or other kinds of formalised agreements, linking the (majority of) stakeholders in a complex social system, that are set up to improve the performance and extension of essential public services.
Objectives:

- To promote the regrouping of communes for sufficient economies of scale to allow hiring specialized professional staff and ensure lower cost service delivery.

- To avoid inflation of small contracts heavy to manage.
Managing Services in Small Towns through Aggregation

Grouping of several municipalities into a single administrative structure for the provision of a service, reflecting realities on the ground.

Aggregated service provider

town A

town B

town C

town D

aggregation
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Management Autonomy, Prerequisite for Utility Performance

- Commercially and professionally run; making decisions on a technical basis
- Insulation from political interference, patronage
- Empowered to do the job efficiently: financial viability, enabling human resource policies, capacity
- As public monopoly, service provider accountable to government; ”regulation”
Basic Options for Structuring the LG – Service Provider Relationship

- LG Department: not the optimum choice
  - insufficient autonomy
  - susceptible to political interference, patronage
  - cumbersome civil service rules (HR, Proc.)

- Public independent, “corporatized” utility: a promising alternative

- Various forms of PSP: successes and failures; succeeds if structured well
What is Corporatization

Empowering of, and creating incentive and accountability structures within, a public utility by legally ring-fencing its finances and management in order to improve services, increase efficiency of operations and allow the utility to access private sector markets (such as finance) more easily.
## Ownership of Fixed Assets and Ownership of Operating Company

<table>
<thead>
<tr>
<th>Mode of sector organization</th>
<th>Who owns fixed assets?</th>
<th>Who operates infrastructure?</th>
<th>Legal status of operator / Legal framework</th>
<th>Who owns operating cy?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct public - regional or local</td>
<td>Government – national, state, local (provincial/municipal)</td>
<td>National, state, provincial, or municipal service</td>
<td>National, state provincial or municipal department / Public Law</td>
<td>Not applicable</td>
</tr>
<tr>
<td>Direct public – ring fenced department</td>
<td>National or state/provincial government</td>
<td>National, state, provincial, or municipal department</td>
<td>National, state provincial or municipal department / Public Law</td>
<td>Not applicable</td>
</tr>
<tr>
<td>WSSU: Corporation - Authority – Statutory Body</td>
<td>Government or WSSU</td>
<td>WSSU</td>
<td>Parastatals, usually defined by special law / Public Law</td>
<td>Government (national, state, provincial, municipal)</td>
</tr>
<tr>
<td>WSSU: Public PLC</td>
<td>Government or WSSU</td>
<td>WSSU, under a concession arrangement</td>
<td>Public limited company (PLC) / Company Law</td>
<td>Government (national, state, provincial, municipal)</td>
</tr>
<tr>
<td>WSSU: delegated private</td>
<td>Government or public asset holding company</td>
<td>WSSU, under an affermage or concession arrangement</td>
<td>Private or mixed company / Company Law</td>
<td>Private partner holds majority of shares</td>
</tr>
<tr>
<td>WSSU: direct private</td>
<td>Government and/or WSSU and/or private sector (partial divestiture)</td>
<td>WSSU</td>
<td>Private or mixed company / Company Law</td>
<td>Private or mixed company, with private partner holding operations responsibility</td>
</tr>
</tbody>
</table>

Source: Janssens (2004), adapted from Blokland & Braadbaart, IHE-Delft (1998)
Italy: Reform process in WSS and electricity service provision

Galli Law, 1994

- Municipality owner of assets
- Corporation of Municipalities owner of assets
- Transfer of assets 100% shareholder
- Operating company Plc (SpA)
- Operating company Plc (mixed company) (SpA)
- Strategic investment partner (51%)

MoC: Municipal owned Company
The “Corporatized” Utility: the Public Limited Company (PLC)

Mimicking a private sector corporation with respect to decision making autonomy, accountability, incentives, professional management, commercial outlook
What Does “Corporate” Status Mean?

- Owned by local government, public organization with its own independent identity
- Legally independent company
- Asset ownership by LG or Provider
- **Non-political** Executive Board as highest authority responsible for utility policies and strategies
- Accountable to LG policies as established in statutes and compacts
- Performance monitored by “regulatory” arrangement
Corporatization: Reasons for Success

- Political and management commitment
- Clear guidelines, regulations and procedures
- Focus on affordability and value for money
- Extensive stakeholder engagement
- Effective communication strategy
But also Failures …

Great successes
- Good way of separating politics from service provision
- Good examples concentrated in industrialized world

Miserable failures
- Political capture of Executive Board a pervasive problem in developing countries (Africa, Latin America)
Importance of Balancing External Accountabilities

Customers

Policy makers

Owners

Regulators

Financiers

Moving center of gravity
Importance of Balancing External Accountabilities

- Put all accountabilities on an equitable footing

- In addition, three external accountabilities for sustainable development
  - Social (political)
  - Environmental
  - Economic
Challenge

Choosing an Institutional Structure with Managerial and Technical Autonomy while keeping the Government and Provider honest
Possible reform path: transfer of assets

- Government department
- Statutory body
- Government owned PLC
- Joint Stock Company
- Non for Profit Private Entity
- Private Company

To a public body that is more autonomous

To an entity partly owned by the private sector → partial divestiture

To a privately owned entity (a company or a non-for-profit trust) → full divestiture
Possible reform path: delegation of management

The asset owner can contract out service provision & operation of assets through a **delegated management contract**. Types of contracts include:

- Service contracts
- Management contracts
- Operators contracts
- Leases/Affermages
- Concessions

Operators can be publicly, mixed, or privately owned.
A multitude of actors and stakeholders

- State
  - Overseeing Ministries
- Local Government
- Regulator/Auditor of sector
- Clients/Users
- Donors
- Banks
- Private enterprise Affermage holder
- Public enterprises and institutions
- Contractors

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Management of risk

- **financial risk**
- **investors banks, IFIs**
- **institutions PPP**
- **service provider utility - operator**
- **in institutional risk**
- **operational risk**

Inter linkages
**PPP: Delegation of management of public service**

Concession contracts for works and management of infrastructure

**Contract plan**

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**STATE**

Overseeing Ministries

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**Regulator/Auditor of Sector**

Operational and functional control

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**Performance Contract**

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**Asset Holding Company**

Contracting of works

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**Contracters**

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**Donors**

Loan Agreements

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**Service Provider (Operating Plc)**

Contracting of works

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**Banks**

Credit / Debt

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**Institutional regulatory Sector regulation**
Central Government
Local Government

Executive Board
CEO

Asset Holding Cy

Subsidy to cover operational deficit

Executive Board
CEO

Operating Company (Plc)

Revenue from user tariffs
O&M costs, renewal

Flow of Funds

Debt service

Subsidy

Issue debt
Donors, Lenders, Investors
Repay debt

(Partial) repayment of debt thru user tariffs

Donors

Issue debt
Donors, Lenders, Investors
Repay debt

Revenue from user tariffs
Contractual Arrangements

- A chain of complex and interdependent contracts
- A multitude of actors and stakeholders
- Fragile equilibriums which require adaptation
- In a stable institutional and regulatory environment, appropriate and flexible
Thank you