

Pipe dreams

The failure of the private sector to invest in water services in developing countries

**DIRTY
AID
DIRTY
WATER**

The investment myth

The water Millennium Development Goal (MDG) commits the international community to halving the number of people without access to clean water and sanitation by 2015.

Meeting this goal means getting clean water to an extra 440,000 people, every day, every year for the next ten years. This is roughly equivalent to supplying new water connections to a city the size of Birmingham every week for the next decade. Achieving this goal requires a massive injection of funding and it is the private sector that has been championed as the solution to delivering this much needed investment.

However, after over a decade of pro-privatisation development policy, less than 1 per cent of private sector investment has been targeted at sub-Saharan Africa and South Asia, the two regions that are home to over half the number of people most in need of connection to a water supply. And in every case in sub-Saharan Africa where the private sector has committed to invest in extending access to water, it has failed to deliver the promised level of investment.

It now seems clear that relying on investment from the private sector, on the scale required to meet the water MDG, is little more than a pipe dream.

The promise

Since the early 1990s international water development policy has been based on promises from the private sector; principally that it is more efficient and that it can provide the much needed investment to extend water and sanitation services to the poor. These arguments have, by and large, proved persuasive to governments, media and the public of rich countries.

This approach has been supported by the Department for International Development (DfID). In a report commissioned by DfID in 2005 to analyse the funding that the UK government gives to the water sector, the consultants concluded: "This is a key period for the programmes which have been developed over recent years to encourage private sector investment in basic infrastructure services.

These may form significant investment mechanisms to leverage investment into the water sector in a way which benefits the poor, if perceived risks to private sector investments can be reduced."

The private sector has been widely viewed as the key mechanism for finding the finance necessary for achieving the water MDG, an amount which is estimated at between US\$51 billion to US\$102 billion for water supply and from US\$24 billion to US\$42 billion for sanitation.

"Privatisation is the only way to get the investment that [poor] countries need in things like banking, tourism, telecommunications and services such as water under good regulatory arrangements."

Clare Short, speaking as UK Secretary of State for International Development

To read the full report *Pipe Dreams: The failure of the private sector to invest in water services in developing countries* please contact WDM (details on back page).

Busting the investment myths

Water privatisation increases the number of new connections

Most privatisation contracts do not require an investment in new connections. There are three main types of contract for the distribution of water services (see box below) and only one of these, concession contracts, requires companies to invest in new connections to the water supply. There have only been five concession contracts in sub-Saharan Africa, six in residential areas in East Asia outside China, and none in South Asia. Yet these regions are home to 80 per cent of the people who need new connections to meet the water MDG targets. Concession contracts do not even always guarantee an increase in the number of connections. In Nelspruit, South Africa, Greater Nelspruit Utility Company (GNUC) claims that it made 5,000 new connections between 1999 and 2001. In the same time, however, GNUC also removed 6,000 meters for non-payment, effectively disconnecting more households from water than it actually connected.

The private sector connects the communities in most desperate need of water

Private sector investment is targeted where it has the potential to make the most profit, rather than where it is most needed. Private companies have been in the driving seat for the past decade and have set the agenda in prioritising continents, regions and cities for water sector investment. Because of their need for profit, companies generally avoid rural areas where about 40 per cent of those needing connections live. Sub-Saharan Africa and South Asia have been the focus of less than 1 per cent of total private sector investment promises. In South Asia, a region with 1.5 billion people, no investments have been made by private water operators in extending water distribution systems.

Water supply contracts

✂ **Concession:** The company runs the water system on a for-profit basis. It is responsible for all investment including new connections. Concessions normally last between 20 and 30 years.

✂ **Lease:** The company is responsible for running the distribution system and making investments to repair or renew existing assets. It is not responsible for new connections.

✂ **Management:** The company manages the water service but does not make any investment. These contracts are risk-free and normally last between one and five years.



A water pipe bypasses unconnected slum housing in Jakarta, Indonesia.

Latin America, on the other hand, has had a disproportionate amount of investment because of its relative profitability. It has a number of middle-income countries, and a relatively small proportion of the population needing connection to water. Yet even there, many contracts are in trouble or have been terminated as a result of public opposition and/or economic instability.

Private companies bring more money

Private companies do not bring new sources or levels of finance. Much of what is traditionally termed 'private finance' is actually available to both public and private operators. Both rely on a mixture of surplus revenue from the water operation; aid from national/donor governments; development bank loans; and/or commercial loans and bonds. The only unique source of finance available to the private sector is equity finance from shareholders.

This often leads to confusion about who is actually providing the money. Senegal is often cited as a private sector success story because of the number of new connections provided. The 35 per cent increase in connections between 1996 and 2001 were, however, largely financed through the public authority rather than by the private company (a subsidiary of the French company Saur). The giant leap in new connections came after 1999 when a new injection of public finance – including a World Bank loan – was provided through the public authority.



PHOTO: MARK HENLEY

Private borrowing is better value

Private borrowing for investment is risky. Initial investment for water contracts normally involves some level of borrowing to raise the required capital. Borrowing by private companies is more expensive than public borrowing, because private companies have worse credit ratings than governments. Also, unlike the local private sector, multinationals are exposed to foreign currency exchange risk. If the local currency is devalued against the dollar multinational companies have to find ways of increasing their revenues to be able to pay back their loans, usually resulting in price rises.

Companies meet their investment targets

Water privatisation often fails to deliver the investment promised. There are numerous examples of companies demanding that their contracts are renegotiated, often changing the levels of investment required (see box to the right).

In sub-Saharan Africa, every contract awarded to increase the number of connections to water has failed to meet the promised level of investment. 80 per cent of the major water privatisation contracts have either been terminated or are the subject of disputes between the public authorities and the operator over investment levels.

Shifting the goal posts

South Africa, Dolphin Coast

The concession (a joint venture including Saur) successfully demanded a renegotiation of their contract after refusing to make contractual payments to the municipality. The revised contract cut the company's investment commitment over five years by 60 per cent, the annual concession fee to be paid to the municipality was halved, and prices were increased by 19 per cent for connected households, and by 80 per cent for users of standpipes.

Buenos Aires, Argentina

Between 1993 and 1998, Aguas Argentina (a Suez subsidiary) only achieved 54 per cent of the agreed investment in the expansion of the existing supply network. Even after several renegotiations of the investment targets, Aguas Argentina continued to fail to deliver on their commitments. They failed to meet 39 per cent of projected investments in the expansion of the water supply network.

Jakarta, Indonesia

In 1997 Jakarta's water supply was awarded to two concessions, subsidiaries of Thames Water and Suez. In 2001 both operators failed to meet new connection targets by a third, as well as other targets in their contracts. In 2001 the contracts were renegotiated with much lower targets, in effect giving companies twice as long to reach the original forecasts. Leakage is estimated to be at 50 per cent, one of the highest figures in Asia.

Gabon

Between 1997 and 2001, SEEG a subsidiary of Veolia, invested \$22 million into water supply across Gabon, supplying 30,000 new connections. In 2004, however, SEEG's underinvestment was blamed for the failure to connect new homes, long interruptions in supply and poor water quality. And in 2004 Gabon suffered its first ever outbreak of typhoid. In 2005 the contract was renegotiated with the investment programme being funded primarily by the World Bank, and savings of the residents of Gabon.

The result

Water privatisation is failing to deliver the investment necessary to connect new communities on the scale needed to tackle the global water crisis.

It is only in Latin America that any significant extension of water connections can be attributed to the private sector, but as one research paper states, "[in Latin America] while connections appear to have generally increased following privatisation, the increases appear to be about the same as in cities that retained public ownership of their water systems."

Misplaced expectations of the private sector have also led to a massive reduction in the level of aid from donors invested in infrastructure, including the water sector. This reduction has been far greater than the actual investment by the private sector. The total invested by all the development banks and donors in infrastructure fell by one-third between 1996 and 2002.

The net contribution of privatisation has thus been to significantly reduce the funds available to poor countries for investment in water. It is likely that donor funds 'missing' from the water and sanitation sector runs into billions.

The future

It is time to fundamentally change our approach to delivering water and sanitation to the poor.

There is no compelling evidence that private utilities either out-perform public utilities or that privatising water utilities leads to unambiguous improvements in performance.

Nor, as this briefing shows, is there persuasive evidence that the private sector can provide the level of investment needed to deliver the number of connections necessary to meet the water MDG.

Currently about 95 per cent of people with a water supply are served by the public sector. It is this sector that we

need to reform and extend. Approaches such as participatory budgeting, progressive tariff structures and cross-subsidy, coupled with reducing leakage rates and increasing efficiency, have shown that it is possible to make public systems work. Massive investment will still be required, and in poor countries this will invariably come from international donors. The policies of donor governments and institutions are therefore critical, so it is imperative that they give their political and financial support to workable public approaches, rather than investing in a demonstrably failed solution.

"... the expectations of the private sector participation in the financing of infrastructure needs were over optimistic."

World Bank Paper 2004.

Take action!



Write to Hilary Benn, Secretary of State for International Development and ask him to review his Department's policy of funding privatisation, and instead to start funding real solutions to the world's water and sanitation problems.



Sign up as a World Development Movement (WDM) activist and receive urgent actions and regular updates on WDM's campaigns. Call or email WDM using the details below.

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