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WATER FINANCE – A DISCUSSION NOTE

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Preface by Hans Engelberts, PSI

The issue of financing water services – and other public services such as energy, healthcare, education – is at the core of the debate on privatisation and commercialisation. Those in favour of privatisation (or liberalisation) contend that the public sector cannot afford to finance these services, that this is a job best done by the private sector.

This is a smokescreen, both to limit the role of the government and to place public services under the control of markets and open them up to for-profit (and often multinational) corporations. One need just look to the ‘restructuring’ of Iraq to see this model in its most extreme form.

In the water sector, this model is not working. The market is not an appropriate mechanism for ensuring the human right to water. The profit motive does not ensure either better and more efficient services nor a more equitable access, especially for the poor. Time and again, the public sector is called in to guarantee corporate profits and to assume corporate risks. And unless the World Bank can create more corporate safety nets with the public money it manages, the major water corporations say that they will no longer invest money in developing countries.

This discussion note is an attempt to clear some of the smoke around the issue of financing. One thing is clear: water services, whether public or private, must be paid for. Although water is ‘free’, its treatment and distribution cost, and must be paid for. In this note, the PSIRU team reviews some of the financing models and assesses their relevance to the current debate in the water sector.

Much more work must be done to develop ‘alternative’ financing models (assuming that the central model is the one advanced by the Bank and the corporations). This work will include solid critical research to determine the limits and possibilities of various models. But a big piece of the work is advocacy – unions, community groups, public utility managers and politicians must be much more aggressive in demanding that financing of new infrastructure not equate with privatisation and commercialisation of public services.

And advocates of the human right to water must continue to monitor the trade agreements such as the GATS, which are being used to restrict the capacities of governments and to entrench corporate control of public services.

PSI and its affiliated unions around the world will continue to work with community groups, NGOs, utility managers and politicians to defend quality public water services.



Hans Engelberts
PSI General Secretary

1 Introduction

This paper examines issues of financing water supply and sanitation systems, including:

- A critique of the 'top down' approach to water finance of the World Bank, the Camdessus report, and the water multinationals
- Proposing a different approach, based on a participatory, 'bottom up', local assessment of needs, and of the best means available for fulfilling them
- a discussion of different methods of raising investment finance for publicly run water systems

It does not attempt to identify a single best method of financing, but to indicate some of the possibilities which are available, together with actual examples of these options in practice.

2 Top down global approach: Camdessus, the World Bank and the multinationals

The key objective of international companies and investors is always to make a good and secure return on capital, even in a vital service like water and sanitation. As a result, issues of protection from risks, profit guarantees and global sources of finance are of central importance – the commercial venture seeks protection from all forms of uncertainty. For public service water and sanitation, a financial return on investment is a cost associated with loan finance, not an objective.

This approach is visible in the leading institutions' approach to water finance. The Camdessus report on water finance to the 3rd World Water Forum at Kyoto in 2003¹ offered bold large figures of the scale of investments needed in water, globally: "This report, and its background papers, indicated that additional annual investment of c. \$100 bn. was required in all branches of the water sector. More should be done at the country and basin level to identify financial resources and investment needs and provide incentives to encourage this finance..." It went on to recommend a number of devices for reducing the risks experienced by private water operators, in order to encourage their activities.

The World Bank's water strategy has already introduced mechanisms which follow the Camdessus recommendations. These include developing guarantee mechanisms against political risks, protection against currency risks, and even structuring municipal bond finances so that they support private sector involvement.² This emphasis on reducing political risks for private investors was already present in the WB's strategy on urban and local government assistance in 1999,³ which stated: "For public-private partnership arrangements such as municipal service concessions, one perceived source of local political risk might be the municipality's continued role as supplier or taker, regulator, landowner, or source of subsidy. In these cases Bank guarantees or limited injections of the Bank's sovereign guaranteed lending could mitigate the municipal risk and help raise private capital... IFC can also participate in capital market

¹ Camdessus, M. (2003) *Financing Water for All - Report of the World Panel on Financing Water Infrastructure*. Chaired by Michel Camdessus. Report written by James Winpenny. Presented at 3rd World Water Forum, Kyoto, Japan, 16th-23rd March 2003 <http://www.worldwatercouncil.org/download/CamdessusReport.pdf>.

² Infrastructure Action Plan. at [http://wbln0018.worldbank.org/UrbanCalendar/urban.nsf/0/b009a39793dc8ca885256d5c00789761/\\$FILE/ATTNKULV/Infrastructure%20Aciton%20Plan%20-%20June%2019.doc](http://wbln0018.worldbank.org/UrbanCalendar/urban.nsf/0/b009a39793dc8ca885256d5c00789761/$FILE/ATTNKULV/Infrastructure%20Aciton%20Plan%20-%20June%2019.doc) . For an analysis of the WB strategy see 'Public solutions for private problems - responding to the shortfall in water infrastructure investment' September 2003 at <http://www.psir.org/reports/2003-09-W-strats.doc>

³ "A Strategic View of Urban and Local Government Issues: Implications for the Bank" October 1999 <http://www.worldbank.org/html/fpd/urban/strategy/full.htm>. Key policy statements are from Chapter 3, at <http://www.worldbank.org/html/fpd/urban/strategy/chap3.htm> .

development, including institution building and special risk mitigation operations benefiting private investors.”⁴

This reassurance and removal of risk reflects precisely the recent concerns of the water multinationals: the plea by SAUR for World Bank guarantees; the insistence by Suez on a secure and high rate of return; and the search by Thames for mechanisms which reduce political risk.⁵ It also reflects the interests of international financial investors and their advisors, such as Pricewaterhousecoopers, with a vested interest in promoting the idea of insufficient public funds in order to create a broader market for their financial services, and displacing existing public sector financing, even where it is effective and cheap. For example, in the Netherlands a private wastewater BOT was set up, despite higher financing costs than would be incurred under the efficient public financing scheme, on the grounds that this would allow better risk management due to diversification of funding sources.⁶

Providing guarantees and protection for international investors however does nothing to help identify where money is needed to provide better water services to people, how those needs can be met, and what finance is required to deliver this service. Eliminating the risk of dying of cholera is different from reducing the risk of an underperforming investment.

3 Finance from the bottom up

3.1 Bottom up assessments: a participatory approach to finance

An alternative approach should start by looking at the actual needs of people, specifying the objectives to be achieved, working out what finance is needed, and how it can be best obtained. This must be a ‘bottom up’ approach, based on local assessments and decisions, because the objectives and needs depend on local conditions.

Public participation, with the associated transparency and accountability, should be an important part of the process, together with public ownership and management. Participatory systems, as operated in Porto Alegre (Brazil), have financial advantages.⁷ Using the participatory system, DMAE has succeeded in financing considerable extensions of service coverage in a decade, and all at a low cost for consumers. Participatory mechanisms:

- are better at identifying investments of value to poor localities
- can develop consensus on pricing levels necessary to fund the system
- can develop consensus on distribution of the costs: ‘the whole city is a tax base’

The table below sets out some common objectives for improving water systems. The actual objectives need to be assessed locally. The table also shows the kind of financial measures which may be part of a solution, including capital investment, subsidy and cross-subsidy, and even higher pay as a way of improving finances of the operator (in Dakha, Bangladesh, doubling workers’ salaries led to a big improvement in the operation’s finances, because workers could ‘afford to be honest’ and the collection rates increased dramatically).

⁴ From Chapter 3, at <http://www.worldbank.org/html/fpd/urban/strategy/chap3.htm> .

⁵ For a discussion of the companies and their strategies, see Water multinationals - no longer business as usual <http://www.psir.org/reports/2003-03-W-MNCs.doc>

⁶ Marray, Michael, “Does anyone give a PPP?”, Project Finance, 1st July 2001 : “...The Dutch [water finance] market has traditionally been quite closed to any external participants, with a lot of reliance upon public sector banks -- Bank Nederlandse Gemeeten and Nederlandse Waterschapsbank -- in providing finance for all of the activities of the provinces and municipalities, and that is quite a hard culture to break,” comments a local banker.”

⁷ See ‘Water in Porto Alegre, Brazil - accountable, effective, sustainable and democratic’ August 2002 <http://www.psir.org/reports/2002-08-W-dmae.pdf>

Table 1. Objectives, finance and other measures

Some possible objectives	Financial measures	Low cost measures
Extension of system	Capital investment in new connections	Legalise peri-urban settlements, self-connection
Improved affordability	Subsidy, cross-subsidy, lifeline tariffs	Reduce costs, improve collection of charges
Reliability and continuity	Better pay, capital investment in new technology	Organisation, training
Improving water resources	Capital investment in reservoirs, pipes, treatment	Maintenance to reduce leakage, reduce demand
Sewerage treatment	Capital investment in treatment plants	Reed beds

There are also non-financial measures which may be as important, or more so. The illegal status of peri-urban settlements may be a more fundamental barrier to connection to water supplies than lack of capital finance; improving the method for collecting water charges may be a simple way of reducing the costs of water to users; reducing leakage, or reducing consumption, may be better ways of dealing with water shortage than building a new reservoir.

Capital investment is not necessarily the best solution, even where it is possible. The notes on 'financing cities' highlight some ways in which spending proposals can distort priorities, by leading to investments which have little benefit to the poor.

3.1.1 Financing Cities: some considerations

- More effective revenue collection (such as revaluing property or enforcement) could increase resources significantly. Exempting low value properties and informal sector businesses would minimise the tax burden on the poor.
- Access to loans may enable cities to undertake capital investment, but can distort choices. The growing bond market has encouraged Bangalore to undertake 'mega-projects' that have little benefit for the poor, often forcing them out and undermining fragile economic and social relationships. In Johannesburg, the need to re-establish credit worthiness was the driving force behind the restructuring programme and expenditure cuts in the late 1990s.
- Resources need to be distributed equitably throughout the city. Devolving some funds to the neighbourhood level can bring decisions about resource use closer to the poor.
- A reappraisal is needed of who benefits from expenditures. Reorienting expenditure patterns from high standards that benefit a few to serving the majority who are poor requires a radical change in official attitudes.
- While the executive needs to maintain control over a city's budget and use of resources, greater transparency is essential to counteract corruption and clientelistic power relationships and to strengthen the influence of the poor through ward councillors.

(extracted from IDS Insights Issue #38 November 2001 by Nick Devas)⁸

3.2 Payment through charges or taxes – the issue of cross-subsidy

Ultimately all expenditure on water has to be paid for either through taxation or through user charges. Even if water is distributed free of charge to the users, it is still paid for – through the tax system. Even loans have to be repaid, with interest, through one of these mechanisms.

The affordability of water for poor users is affected by the distribution of the burden. In any system, there is nearly always some element of cross-subsidy. The more that costs are covered by taxes, the less is paid by users: people with lower incomes are expected to pay less taxes, so they pay less overall for the cost of the water system. The same is true with local taxes, to a lesser

⁸ Insights Issue #38 November 2001 <http://www.id21.org/insights/insights38/index.html>

extent, because the population may consist overwhelmingly of poor people, and so there are few wealthy people to subsidise the poor.

Charges can also be distributed so as to assist the poor, usually by a system of ‘block tariffs’ under which people pay less for the first 50 litres of water per day, and progressively more per litre for higher bands of consumption. Giving the first 50 litres for free (sometimes called lifeline tariff) is an example of this. It does not necessarily benefit the poor, however, but low consumers: a single rich person gets more benefit than a poor large family. However, charging for water is often supported as a way of reducing consumption and conserving water, so environmental interests sometimes argue in favour of charging everyone for all the water they use.

Table 2. Taxation and charges

	Taxation	Charges	Cross-subsidy mechanisms
National	National taxes	-	Tax base eg income tax, VAT
Local	Property tax, water tax	Connection charge	Tax base eg property values
Local (use-related)		Metered charges	Rising block tariffs, ‘free water’

3.3 Central and local taxation

Historically central governments have played a big role in financing water systems. This has sometimes involved paying directly for the water supply service as a whole, so that there is virtually no role for charges (eg Ireland); distributing some part of central tax revenue to support local authority spending on water and other services (eg Canada); providing cheap loan finance for local authorities to use for capital investment (eg USA); or collecting some part of water charges centrally and redistributing it to authorities which need to invest (eg France).

The great advantage of using central government financing is that it enables the greatest redistribution, by drawing on taxes paid by everybody in the country and directing it where it is most needed. The poorer the population of a community, the more they need finance from a source which can draw on richer communities.

The disadvantage is the lack of local control over this revenue: central government may cut back on the amount it is prepared to spend on water, and so local communities may depend on decisions made at levels they cannot easily influence.

In many countries water and sewerage have been local government services financed, like other services, out of local taxation, such as a form of property tax. Even where there is a separate charge for water, this charge may effectively be a property tax in countries where most homes are not metered – e.g. the UK or Canada.

3.4 Structures and capacity: communities and public authorities

Attempts to provide improved services for the poor are often ‘community-based’, through an organisation which is not a municipality or any other state institution, but may be a cooperative, a voluntary neighbourhood association, or some other form of NGO. The arguments in favour of community/NGO based water services is that they avoid problems experienced with state organisations, including inefficient and/or corrupt bureaucracies, self-serving politicians and bureaucrats, and lack of transparency and accountability (though community leaders too may sometimes exhibit these problems).⁹

⁹ In practice there is no guarantee that community leaders will not pursue self-interest in the same way as bureaucrats or politicians. Leaders of a particular group may act in their own interests rather than that of the community as a whole, for example where commissions are made available to community leaders for collecting water charges as practised by Suez in Manila, for example.

There are a number of cases of local communities developing a self-help approach to extending water systems, especially in peri-urban areas: one such case is Faisalabad (Pakistan) – see box below.

A community however has more limited financial powers than a municipality or local government. It can only develop water or other urban services on the basis of the ability to pay of the actual or potential users. Without powers of taxation, it will not be able to rely on the resources of people other than the users. Its ability to borrow will be limited by the income from users, and it will almost certainly be unable to issue bonds or take long-term loans - there are few cooperatives whose dimension allows them to access long term investment finance at good terms and conditions: one of these is SAGUAPAC in Santa Cruz, Bolivia.¹⁰

Communities have the further disadvantage of not being able to employ a significant number of staff either to carry out services or to provide professional advice (for example, in Faisalabad the community could not recruit and retain qualified engineers).

3.4.1 Faisalabad: micro-financed community water and sanitation

Two-thirds of Faisalabad's two million people live in *katchi abadis* (unofficial squatter settlements) with little or no official provision for services. Over half the population are self-employed, and the settlements contain many small businesses. Less than half of the houses have piped water and less than a third are connected to sewer systems. As the city's water and sewerage authority is chronically in debt, many neighbourhoods develop projects independently, often using grants-in-aid allocated by individual politicians. There is little co-ordination. Although most settlements have trunk sewers, many local sewers and drains are not connected to them.

The ASB is a neighbourhood body which has introduced self-financed water and sanitation connections in *katchi abadis*. This consciously emulates the Orangi Pilot project (OPP) in Karachi, which developed low-cost sewerage through community-financed connections in *katchi abadis* in Karachi. These proved so successful that a sewerage scheme for the whole of Karachi was revised to use the same approach: an earlier plan to use an expensive loan from the Asian Development Bank (ADB) was cancelled.

The ASB undertook a survey to document and map existing water and sewerage facilities in the areas in and around Dhuddiwalla. The OPP itself lent Rs 100,000 from which micro-loans were made households and businesses to construct their own local sewerage and water connections in the lanes of the settlements, and repay the loans: the repayment rate has been over 88%. When WASA said it could not make the connection to water mains for some years, the ASB took responsibility by creating a local water services committee (WSC), raising a Rs 200,000 loan (from Wateraid), constructing the connection itself (illegally) and undertaking to collect user fees from households. Households pay both the WSC and WASA when they are connected. Some households refused to pay connection charges, but both WASA and the WSC took legal action to disconnect them and force them to pay charges to both WSC and WASA. A similar process of raising a loan from Wateraid and issuing micro-credit was used to develop local sewerage links. ASB has effectively become a provider of sewer maintenance services, substituting itself for WASA in this respect. It has bought equipment for unblocking sewers, and a truck, with grants from Wateraid.

The project has turned down funding offers from other donors including the Canadian CIDA in order to avoid pressure from big financiers. It has also declined funding from the Social Action

¹⁰ See Lobina and Hall 1999: 'Public Sector Alternatives To Water Supply And Sewerage Privatisation: Case Studies' <http://www.psiu.org/reports/9908--W-U-Pubalt.doc>

Programme (SAP) of the government of Pakistan, and convinced the municipality not to invest in water supply or sewerage at the lane level but to spend their funds on building collector sewers and paving the lanes where water supply and sewage lines have been completed. The ASB has tried but failed to recruit and retain professional engineers. It is heavily reliant on the personality and drive of one leader. Although international donors have come to offer support, this has rarely been accepted, lest it compromise ASB's belief that development should be dictated by the commitments, priorities and means of local inhabitants.¹¹

The political context of Faisalabad is significant. The Faisalabad Development Authority (FDA) is the main policy-making body but is not elected and is funded from central government; the water and sanitation authority (WASA) is under the direction of the FDA but has irregular funding and very poor collection of water and sanitation fees. The Faisalabad Municipal Corporation is an elected local authority, but has no effective power over the actions of the FDA, no reliable income from the provincial government, and also fails to collect its own taxes efficiently. Individual politicians are an important channel of finance, because the government gives "grants-in-aid" to each national and provincial assembly member to spend on their localities, with no coordination. Neighbourhoods often take the initiative in trying to develop water and sanitation schemes, and seek funding from the politicians. As a result local sewers and drains are often not connected to nearby WASA mains sewers. The ASB does not alter these political and financial systems, but provides an initiative which delivers services within these systems.

(PSIRU summary based on 'The work of the Anjuman Samaji Behbood and the larger Faisalabad context, Pakistan', Poverty Reduction in Urban Areas Series, Working Paper 7, International Institute for Environment and Development, by Salim Alimuddin, Arif Hasan and Asiya Sadiq, December 2001.)¹²

4 Raising investment finance

There is no single 'correct' source of finance for investment. It will depend strongly on local conditions, including the financial health of the water operation, the quality of democratic institutions, on the state of local and central government finance, on the state of a local capital market, etc.

The sources of investment finance can be set out fairly simply. Either it is generated by the operation itself running a surplus, or it is given by some agency, or it has to be borrowed in some way from investors. Money can be borrowed from inside the country, or internationally. The table sets out these options.

Table 3. Sources of finance for investment

Source of funds	Domestic (inside country)	International
Surplus of operations	Water operator	-
Grants	Government, national funds	Aid agencies, charities
Loans	Domestic banks	International banks, development banks
Bonds	Domestic bonds	International bonds

¹¹ 'The work of the Anjuman Samaji Behbood and the larger Faisalabad context, Pakistan', Poverty Reduction in Urban Areas Series, Working Paper 7, International Institute for Environment and Development, by Salim Alimuddin, Arif Hasan and Asiya Sadiq, December 2001 http://www.iied.org/docs/urban/urbpov_wp07.pdf . A summary of the main points is also available at <http://www.id21.org/zinter/id21zinter.exe?a=4&i=s2bsa1g1&u=3ff61198>

¹² 'The work of the Anjuman Samaji Behbood and the larger Faisalabad context, Pakistan', Poverty Reduction in Urban Areas Series, Working Paper 7, International Institute for Environment and Development, by Salim Alimuddin, Arif Hasan and Asiya Sadiq, December 2001 http://www.iied.org/docs/urban/urbpov_wp07.pdf

4.1 Surplus of operations

The simplest source is for the water authority itself to finance investment out of a surplus. This means raising income above the levels required just to pay operating costs and debt service, so that there is extra cash which can be invested. Using surpluses in this way avoids borrowing costs. However, water systems are so capital intensive that it would require large surpluses (and high tariffs) to finance all investments out of operating surpluses. Borrowing money has the advantage of spreading the cost across a number of years.

4.2 Local capital and local government finance

Money can be borrowed within a country, from banks or from a local capital market where savings are invested. This is the traditional form of borrowing for local government services throughout the world. One advantage of using local capital markets is that there is no risk from currency devaluation. The money is lent and repaid in local currency, and paid for out of charges (or taxes) collected in the same currency. A second advantage is that it is not subject to conditionalities imposed by external lenders, especially by development banks. Local authorities or water companies will still have to satisfy local investors that they are good credit risks, and will repay the loans on schedule.

The amount of money that can be borrowed from local sources varies between countries. It may however be possible to borrow local savings for investment in public infrastructure such as water even in low income countries. One example of this is the development of municipal bonds in India, led by the city of Ahmedabad (see box below).

4.2.1 Ahmedabad: local government municipal bonds

In the mid-1990s Ahmedabad Municipal Corporation (AMC) was in financial deficit, but needed to carry out

major improvements to services, especially investment in water and sanitation infrastructure. It set about a programme of increasing the efficiency of its tax collection. The main source of revenue was from an

'octroi' tax levied on imports into the city: AMC updated the rates of tax, employed extra collectors, stamped out corruption – and as a result increased the amount of money collected by 60%. Within property taxes, the next major source of revenue, the council created a computerised database, imposed sanctions on people who were not paying, and strengthened the collection staff – and tax collected increased by 55%. AMC also computerised, modernised and professionalised its accounting system.

It then drew up a capital investment programme worth Rs 5,973 million (\$150m), mainly for water supply

and sewerage schemes, based on financing 30% of it from revenue and raising the rest through loans and a municipal bond. In 1998 Ahmedabad became the first city in India to issue a municipal bond, which was given a credit rating of AA. The most significant investment was the Raska Project, a bulk water supply scheme which now supplies water to 60% of the city's population. It was completed in a record five months, and financed 20% from the proceeds of the bond, with the other 80% coming from a loan from the national government's Housing and Urban Development Corporation. Other Indian cities followed suit: by 2002 six other municipalities (Bangalore, Ludhiana, Nasik, Nagpur, Madurai and Indore) had issued bonds worth Rs. 550 crores: (one crore is 10 million) all of which were over-subscribed.

(extracted from 'Public Services Work!' Public Services International (PSI) September 2003
<http://www.world-psi.org/>)

For local governments to borrow money or issue bonds there must be both a local source of capital and financial management structures in place in the municipality. One way of providing the funds is through a capital market, another is through the government creating an intermediate fund. The box below outlines the situation in Thailand, where such conditions are being developed.

4.2.2 Thailand

Local government in Thailand remains highly dependent on the central government financial assistance. On the revenue side, the local governments are unable to mobilize resources in their jurisdictions to finance an increased volume of expenditures. These are due to few and narrow tax bases assigned for them and so they are limited in revenue generating capacity. "The local governments have to look for other sources of revenue to finance their expenditure burden. Borrowing has been suggested as an alternative revenue source for Thailand local governments... But it is necessary to design local fiscal systems... to meet mandatory condition of a relatively well-developed financial market to have a prudent local financial system." The financial sector in Thailand is sophisticated and well developed to international standards in many aspects. ...but local bond financing in Thailand today does not exist. There is lack of awareness of the benefits of bond financing among local government people. ...However, if there is uncontrollable access to capital markets and mismanagement of budgets by local government, it could jeopardize stability on the national economy. For this reason, local budget in Thailand is subjected to tight central control and monitoring. Such rule may, on other hand, help to enhance creditworthiness of local government, yet it can also render to inflexibility or negative incentive for local bond market development." Historically borrowing by local government has been restricted: "The only source of funds for local borrowing is from local trust fund, essentially the local government's saving which is imposed by the law. The second problem that hampers local government from borrowing is lack of local financial management capacity. At the fundamental level, local governments in Thailand have weak accounting and budgeting practices. In Thailand a regional fund has been set up to develop LG capacity for borrowing : the Government Savings Bank, with support from the World Bank created the Regional Urban Development Fund (RUDF) as a revolving fund for local borrowing especially for municipalities. The size of the fund was set at 30 million US\$ to spend on loan projects of less than 15 years. As part of establishment the RUDF, considerable technical assistance was provided to strengthen local government's capabilities in preparing and managing projects, financial reporting, and enhancing local accountability.

4.3 National bodies and water banks

Organisations which are owned or supported by governments, such as nationalised industries or banks, also borrow money. The support of the government is a crucial factor for their credit ratings, as it reassures investors that the money will be repaid by someone, and so the credit rating agencies see public ownership as a positive virtue.

These include public sector financial agencies which are dedicated to providing loan finance for municipal investors. The outstanding example of such an agency, dedicated to funding investment by water operators, is the Dutch water bank, Nederlandse Waterschapsbank (NWB). NWB receives the highest possible international credit rating from S & P (see box). An example from a developing country is the Local Water Utilities Administration, which acts as development bank, technical support agency and informal regulator in the Philippines, which helps the positive performance of the Philippine Water Districts.¹³

State financial institutions may provide loan finance more generally to local governments. Some of these have international credit ratings, for example the Japan Finance Corp. for Municipal

¹³ See Lobina and Hall 1999: ' Public Sector Alternatives To Water Supply And Sewerage Privatisation: Case Studies ' <http://www.psiu.org/reports/9908--W-U-Pubalt.doc>

Enterprises (JFM). Or the state may own a development bank which has the remit to provide low-cost investments in order to develop the national economy. One such example is the Brazilian Banco Nacional de Desenvolvimento Economico e Social (BNDES), which has an international credit rating.

4.3.1 Nederlandse Waterschapsbank

Ratings Commentary from Standard And Poor's 'Government-Supported Enterprises Special Edition 2003'

Nederlandse Waterschapsbank N.V. NETHERLANDS Credit Rating : AAA/Stable/A-1+

The ratings on Nederlandse Waterschapsbank N.V. (NWB) are based upon the implicit support that the bank receives from the Ministry of Finance (MOF). The ratings on NWB are also supported by the bank's effectively zero credit risk (as a result of its strict public-sector lending remit), strong capital ratios, an exceptionally low cost base, and stable management. According to NWB's articles of association, the bank cannot lend to nor be owned by the private sector. The majority of lending is to housing associations, municipalities, and water control boards. The bank also acts as a central treasury for the water control boards. Although NWB has commercial independence, central government support is indicated by the bank's shareholders, which are all public-sector entities, with the central government holding 17%; water control boards holding 81%; and provinces holding 2%. The loan portfolio is extremely low risk, and is made up of credits to Dutch public authorities and limited-liability public utilities. NWB has never suffered a loan loss, with the bank's very conservative credit culture effectively leaving it immune to credit cycles. The market for public-sector lending is a low margin business, but NWB is well placed as a low-cost, niche player with a strong public-policy function.....¹⁴

4.4 Corporatised water authorities

Some water operators remain 100% owned and controlled by the public sector, but have a greater degree of autonomy, like a wholly owned company rather than a municipal department. Such a corporatised water operator may then use its own revenues as the basis for borrowing directly, without going through local authorities. This is done by a number of European municipally owned water companies: Stockholm Vatten for example borrows money itself, and even obtains lower interest rates than Stockholm City council.

This kind of corporatised entity also exists in a number of developing countries. In at least one case, Emcali in Colombia, the corporation concerned obtained an international credit rating (though Emcali was subsequently undermined by energy liberalisation, and put under great pressure to be privatised).

In some countries water operators are owned by national governments, as opposed to local government, and then the implied support of the national government becomes important for obtaining loans. In South Africa, for example, although municipalities run water distribution to households, bulk water supply is managed by large regional state-owned operators. One of these, Rand Water, has an international credit rating.

¹⁴ 'Government-Supported Enterprises Special Edition 2003' February 2003 • 139
www.standardandpoors.com

4.5 International finance

4.5.1 General considerations

There are two important questions to be addressed in considering the role of international finance:

- Firstly, it is important to carry out an assessment of what investment finance is actually needed, and how much of it can be financed locally, before looking for finance from development banks (or any other international source). This assessment should be carried out locally and transparently, as development banks, private companies and consultants all have vested interests in making the largest possible estimates of investment needs.
- Secondly, international finance by definition comes from outside the country and so by definition in a foreign currency, invariably the US dollar. The interest and the loan itself must be paid in dollars, whereas income from taxes or water charges comes in local currency. If this currency falls against the dollar, then the cost of the loan may become unaffordably high.

4.5.2 Development banks

Development banks should be the main source of international finance for public infrastructure investment. This is a key role of a development bank, and the advantage is that money is available at much better terms than the public authority could obtain for itself. Problems arise, however, because the banks may apply conditionalities requiring private sector involvement, and the loan may be used as way to impose policies which damage public services. Despite this, the development banks all continue to lend to public sector bodies, and the conditionalities applied vary considerably.

4.5.3 International bonds

Bonds are issued on the international money markets by most governments. Bonds are also issued internationally, not only by municipalities in developed countries, but by some local governments in transition and developing countries too.

Standard and Poor's specify the factors they take into account for credit rating local governments.¹⁵ The credit rating of the national government is usually the most important factor, but S & P list factors which are specially relevant to rating municipal bonds in 'emerging markets' (developing countries). These include: changing relationships between central and local government, lack of institutionalized accounting and audit, management sophistication, culture of debt repayment, legal and regulatory frameworks, debt profiles and liquidity, incomplete demographic and socioeconomic data, scale of infrastructure needs, and level of uncollected taxes and fees.

Few municipalities in developing countries have obtained international credit ratings (except for Mexico). The majority are in eastern Europe. The table below excludes 3 cities in Argentina which now have a 'Default' credit rating.

¹⁵ See 'Local and Regional Governments 2003', criteria and definitions at <http://www2.standardandpoors.com/NASApp/cs/ContentServer?pagename=sp/Page/FixedIncomeBrowsePg&r=1&b=2&s=16&ig=&i=&l=EN&fi=&fig=&fs=&fr=&ft=&f=2>

Table 4. Municipal bonds with international credit ratings, 2003 (transition and developing countries)

		Local currency	Foreign currency
Colombia	Bogota (Capital District of Santa Fe de)	BBB-/Negative/—	BB/Negative/—
Korea	Seoul (Metropolitan City Government)	A+/Stable/A-1	A-/Stable/A-2
	Taegu (Metropolitan City Government)	BBB+/Watch	BBB+/Watch
Bulgaria	Sofia (City of)	BB/Stable/—	BB/Stable/—
Croatia	Zagreb (City of)	BBB/Stable/—	BBB/Stable/—
Czech Republic	Brno (City of)	A-/Stable/A-2	A-/Stable/A-2
	Olomouc (City of)	A-/Stable/A-2	A-/Stable/A-2
	Ostrava (City of)	A-/Stable/A-2	A-/Stable/A-2
	Prague (City of)	A-/Stable/A-2	A-/Stable/A-2
Hungary	Budapest (City of)	A/Stable/A-1	A-/Stable/A-2
Latvia	Riga	BBB/Positive/A-3	BBB/Positive/A-3
Lithuania	Vilnius	BBB-/Stable/—	BBB-/Stable/—
Poland	Bydgoszcz (City of)	BBB-/Stable/—	BBB-/Stable/—
	Gdansk (City of)	BBB-/Stable/—	BBB-/Stable/—
	Krakow (City of)	BBB-/Stable/—	BBB-/Stable/—
	Lodz (City of)	BBB-/Stable/—	BBB-/Stable/—
	Szczecin (City of)	BBB-/Stable/—	BBB-/Stable/—
	Wroclaw (City of)	BBB-/Stable/—	BBB-/Stable/—
Russia	Bashkortostan (Republic of)	B/Positive/—	B/Positive/—
	Cherepovets (City of)	RuBB	—/—/—
	Irkutsk	Oblast —/—/—	B-/Positive/—
	Khanty-Mansiysk (Autonomous Okrug of)	RuAA	BB-/Stable/—
	Moscow (City of)	—/—/—	BB/Stable/—
	Moscow (Oblast of)	RuA	B-/Positive/—
	Samara Oblast	—/—/—	B+/Stable/—
	St. Petersburg (City of)	BB/Stable/—	BB/Stable/—
	Surgut (City of)	RuA-/Stable	B/Stable/—
	Sverdlovsk (Region of)	B-/Positive/—	B-/Positive/—
Ukraine	Kiev (City of)	B/Negative/—	B/Negative/—

Source: Standard and Poor's 'Local and Regional Governments 2003' www.standardandpoors.com¹⁶

4.5.4 International commercial finance: intermediate mechanisms?

International investors include the world's investment funds, with capital looking for the best/highest/most secure return. Most of this is unlikely to be interested in investing in water infrastructure in developing countries, which would be perceived as too risky and not profitable enough, although some water bodies with international credit ratings will be able to attract such investors. 'Ethical investors' may be more interested, as the value of the service is a positive factor for them, but would still prefer to spread the risks of such investments. International private capital may be more interested in investing through 'intermediate funds' of various kinds, which spread the risk of the investor, and carry out the specialised function of assessing the different water operators or municipalities.

¹⁶ Standard and Poor's 'Local and Regional Governments 2003' www.standardandpoors.com

5 Comments and conclusion

Financing water to meet the needs of people does not necessarily require international capital. Poor communities may be capable of mobilising the necessary resources to construct domestic extensions even if the government, municipal and water authorities are failing to function. Public water services can be made affordable for the poor through a combination of taxation, charges, efficient collection methods, and cross-subsidy. Investment finance can be raised through loans or bonds issued within the country itself, if basic requirements for capital markets exist. Governments, and even local governments, are themselves capable of accessing international capital if necessary, without the need for private companies. Development banks should have a role to play, but that depends on whether it is possible to prevent the damaging effects of policy conditionalities.

PSIRU	Water is the future	Berlin	April 2005	www.psiru.org
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Water governance –strategies for the Millennium Development Goals

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Summary

- Water as a human right
- Mobilising capital
- Privatisation and PPPs
- Public-public partnerships and participation
- Governance and democratic institutions

Water as a human right

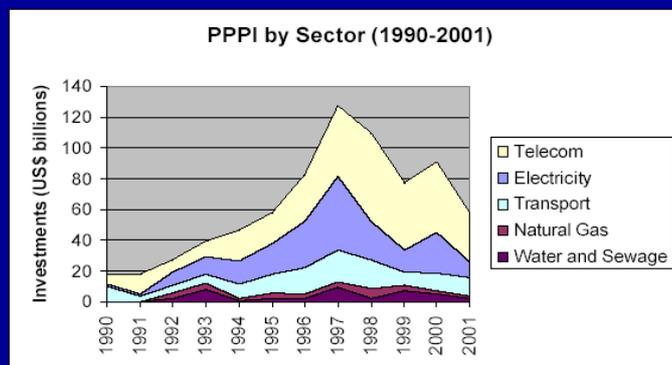
- Not a right to free water supply
 - Always product of labour, voluntary or paid
- Right to equality in water supply
 - Rich/poor, legal/illegal, black/white
 - South Africa water right = part of ending apartheid
- ‘Human right’ = political demand
 - Equality preferred to market forces
 - Requires political action to deliver
- Other conventions/declarations require same effort

Mobilising capital finance

- Assess investment needs from bottom up
 - top down approach of Camdessus sees water as market
- Financial planning from bottom up
 - Local charges/taxes+cross-subsidy; national tax+subsidy
 - Create network connections, not abolish subsidies
 - Local/national govt internal borrowing: bonds
 - International finance should be residual: least sustainable
 - Should support local plans and supplement local financing
- Potential for international investment in local bonds
 - Ethical investors, pension funds, ODA takes risk premium

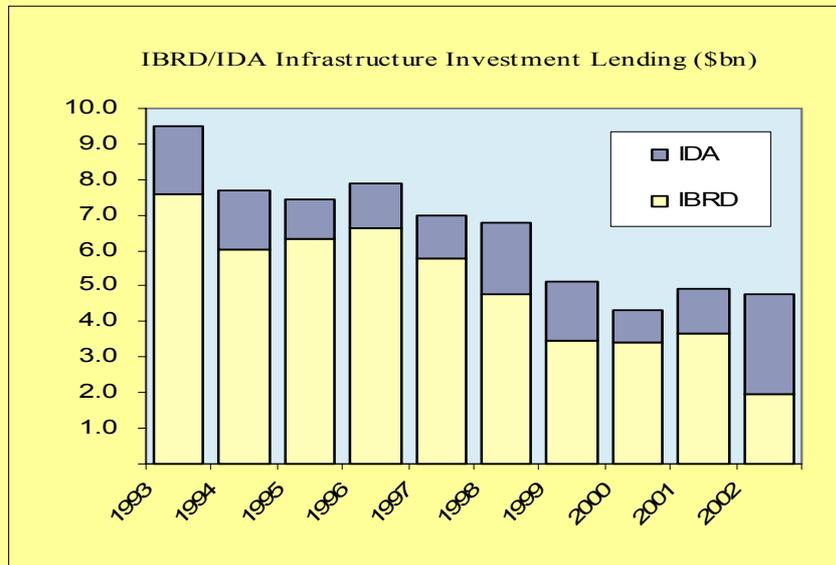
Privatisation and PPPs: decline in private investment

Total private investment by sector: divergent levels and volatility



Source: World Bank: Private Infrastructure: a Review of Projects with Private Participation, 1990-2001

Decline in world bank lending on infrastructure



Privatisation and PPPs

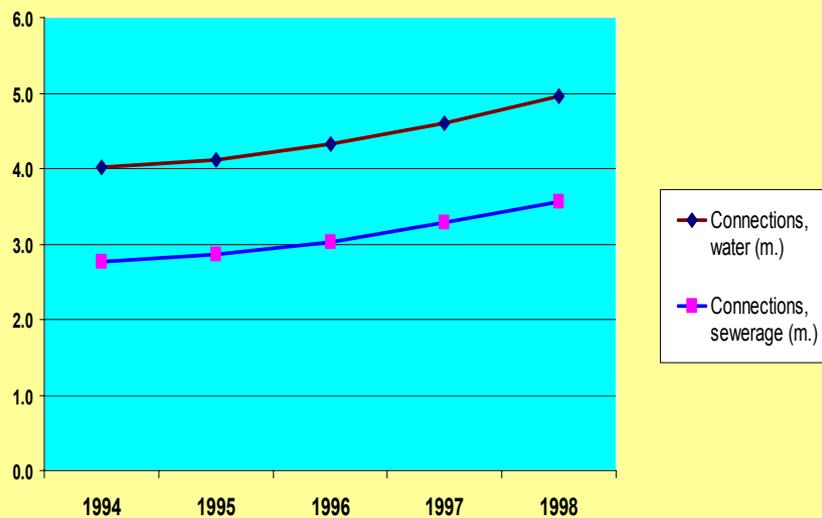
- Failed to deliver in decade of privatisation 1992-2002
 - private finance has accounted for less than 10% of total investment (WB 2003)
 - unsustainable politics, economics: 'sad reality' (Thames Water)
 - Low % of equity, most investment local or IFI eg Aguas Argentinas
 - Management contracts safe, but no investment
- PPPs bring high risks for countries
 - Guarantees bring unquantified future liabilities (IMF 2004)
 - Cost of water from BOTs with guarantee payments, like IPPPs
 - Similar problem in Berlin
 - Compensation claims eg Tucuman, Cochabamba, Szeged Cf Potsdam buy out Suez
 - Exits leave reconstruction problems
- IMF adjusts policies because limits on public spending cut growth (IMF 2004)
 - infrastructure cuts in 90s cut long-term growth by 3% p.a. in Arg/Bolivia/Brazil
 - IMF now allows Brazil et al to make public sector borrowing and investment
 - WB acknowledges problem, but EU, WB, donors still promoting privatisation
 - EUWI, PPIAF, Guarantco, BNWP, etc
 - GTZ in El Alto, Bolivia

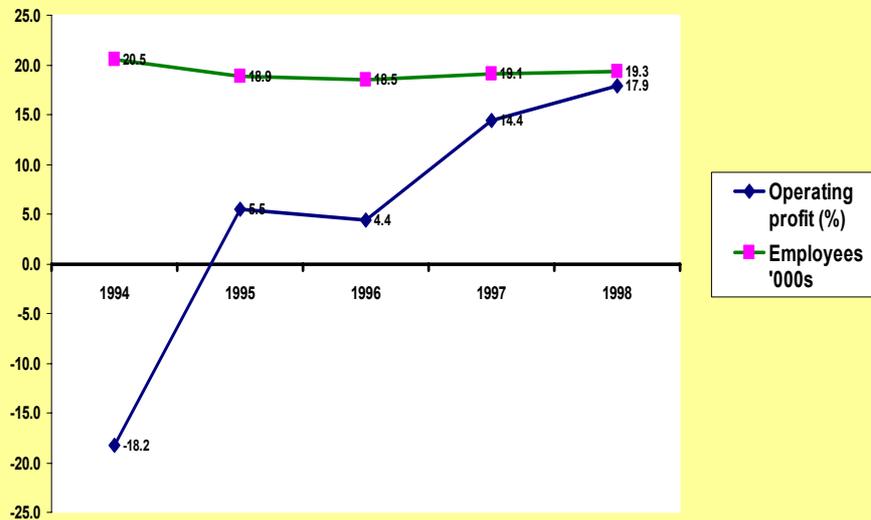
Public-public partnerships and participation

- Public sector not less efficient
 - Latin American extensions public/private equal (Clarke 2004)
 - USA efficiencies public/private equal (Clarke 2005)
 - no clear evidence of private sector more efficient (IMF 2004)
- Public-public partnerships
 - Role in capacity-building eg Baltic states “twinning”
 - Potential role in sustainable training programmes
- Participatory mechanisms work
 - eg Porto Alegre: better priorities, legitimises charges
 - Direct action/voluntary labour eg Pakistan, Brazil
 - TAP campaigns, eg Maharashtra (India) (electric)

Extension of system connections

SABESP, Sao Paulo



Improved finances, no job loss**SABESP, Sao Paulo****Governance – building democratic institutions**

- General problem of weak public institutions, weak political legitimacy
 - not a problem of the water sector alone
 - need stronger public authorities, not weaker state (Fukuyama 2004)
 - Build on strength of campaigns (“Reclaiming public water” www.tni.org)
 - Eg Hamburg, cf El Alto
- Public finance is key for legitimate institutions
 - Legitimate taxation, borrowing capacity eg Ahmedabad (India)
 - Build capacity for bonds, local capital markets eg USAID
 - Non-market redistribution: cross-subsidy, subsidy
 - Community finance positive but limits cross-subsidy eg Faisalabad (Pakistan)
- Global north should support for these developments eg transparency
 - Build capacity of political institutions; training; support bonds
 - Possibility of pooled public water bonds being investment vehicle for ethical/pension funds

What is the global public finance equivalent of ending apartheid?

The **Public Services International Research Unit (PSIRU)** is part of the Business School, and also has strong links with the School of Computing and Mathematical Sciences. It conducts empirical and policy research into the restructuring of public services around the world. PSIRU has a multidisciplinary research team using economics, politics, and social policy to address restructuring, liberalization and privatization of public services across Europe and worldwide, especially in the sectors of water, energy and healthcare.

PSIRU has an international reputation for its work in this area, and PSIRU researchers have been invited to present papers at numerous academic conferences in Europe, north and south America, Africa and Asia; to make presentations to meetings of international institutions including the World Bank, OECD, the United Nations, UNCTAD, ILO, and the European Parliament; to prepare presentations and reports for a number of national governments, including the USA, Brazil, South Africa and South Korea; and to present to conferences organized by civil society groups, including the world congress of Consumers International.

In addition to publication in academic journals, PSIRU publishes commissioned research papers on its website (www.psiru.org) and maintains a database monitoring privatisation in water and energy sectors. The papers include reviews of developments in liberalization and privatization of specific sectors by region or sub-region, critical analyses of European Commission policy papers concerning services of general interest (SGI), public private partnerships, and the evaluation of the impact of liberalization on SGI.

PSIRU's database and many of its reports are commissioned by international confederations of trade unions, civil society groups, and national governments. PSIRU has carried out global research on privatization and restructuring in water and energy and healthcare funded by the ILO and UNRISD, and on corruption, funded by the Wallace Global Foundation. PSIRU is the lead coordinator of a 3-year FP5 research project, Watertime, which is developing support tools for decision-making on water systems in cities (contract no: EVK4-2002-0095:); participated in a CIRIEC study for DG Regio on the contribution of SGEI to social and territorial cohesion, and in another DG region study on water and participation in Slovakia; led a study for Eurelectric and EPSU on the skills needs in the electricity industry in Europe; and has carried out other EC-funded studies on the scope for European Works Councils in the water and energy and healthcare sectors.