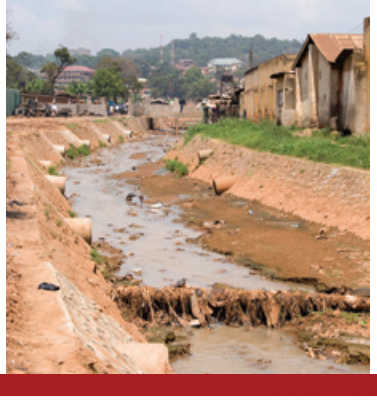
WATER

P-NOTES

ISSUE 31



APRIL 2009

47930

Guiding Principles for Successful Reforms of Urban Water Supply and Sanitation Sectors

One of the Millennium Development Goals (MDG) is to halve, by 2015, the proportion of people who did not have sustainable access to safe drinking water and basic sanitation in 1990. The UNICEF/WHO Joint Monitoring Program (JMP) reports good progress on access to drinking water in urban areas, although the proportion of the population with direct access to piped water through individual connections has decreased between 1990 and 2004 in Sub-Saharan Africa and Southern Asia. These two regions, together with South-Eastern Asia, are also off target for access to sanitation, in particular through connection to sewers.

Bridging the Gap between Infrastructure and Service

The JMP data mostly measure access to water supply and sanitation (WSS) infrastructure. Infrastructure alone does not automatically translate into service if policies, incentives or institutional arrangements are inadequate. Even if the WSS infrastructure is well developed, service could be unreliable if the lack of incentives to comply with service standards results in piped water being available on an intermittent basis and thus of uncertain quality. Service could also be financially unsustainable because pricing policies or commercial operations are inadequate, resulting in collected user charges insufficient to cover operation and maintenance (O&M) and capital costs. Water supplies could be environmentally unsustainable as well, when local aquifers are depleted or polluted by customers who have to develop and operate substitutes to complement a deficient piped WSS service. Or service could even be unaffordable by low income groups, despite tariff levels and structures intended to protect them, when insufficient revenues translate into a piped WSS service of poor quality and force the poor to revert to expensive and unsafe substitutes.

Reforming urban WSS sectors is needed to improve the reliability, sustainability and affordability of the WSS service; there are good examples of countries in Latin America, Eastern Asia, Middle East and North Africa or Sub-Saharan Africa that are on track for achieving this objective, and thus the MDG, because they successfully reformed their urban WSS sectors. Obviously, there are no "one-size-fits-all" solutions to the many problems of poorly performing urban WSS sectors.

While solutions have to be tailored to diverse local circumstances, many of the issues to be addressed are often similar. Consequently, this Note proposes a structured methodology for engaging in urban WSS reforms, presents what is usually accepted as best practices, and discusses conditions under which they have been successfully implemented. The Note focuses primarily on the provision of official piped WSS service, but it also recognizes that when a central service provides limited coverage or poor performance it can forfeit its monopoly status, whereupon alternatives to the piped WSS service often play an important role.

The following note summarizes key points of "Guiding Principles for Successful Reform of Urban Water Supply and Sanitation Sectors," by Alain R. Locussol and Matar Fall (World Bank Water Working Note 19, February 2008). Readers may download the complete paper from www.worldbank.org/water.

Understanding the Reasons for a Poorly Performing WSS Service

The Note emphasizes the need to carry out a rigorous diagnosis of the reliability, sustainability, and affordability of the WSS Service using indicators such as that developed by the International Benchmarking Network for Water and Sanitation Utilities (IBNET). In many countries, however, the lack of reliable data on technical, commercial, and financial operations is a major impediment. Designing and implementing a program aimed at generating quality data is often one of the first issues to be addressed to help design improved policies monitor progress and monitor progress. The Note again underscores the need for properly documenting the role played by alternatives to a deficient piped WSS service.

The Note proposes a methodology for assessing the accountability framework of an *urban WSS sector* that it defines as the set of actors, mandates, contractual arrangements between actors, and instruments used by actors to implement their mandates. The accountability framework focuses on the five key functions of the urban WSS sector that are policy formulation, asset management and infrastructure development, service provision, financing and regulation of the service. The Note recommends that particular attention be paid to incentives, either productive or counterproductive, that could influence the performance of the WSS service. It also suggests identifying vested interests likely to be affected by reforms, with a focus on those engaged in fraud and corruption, as they could actively lobby against reforms which, if successfully implemented, would affect their revenues.

Addressing Nine Key Issues to Successfully Design and Implement Reforms

The methodology considers nine key issues to build a sustainable and effective effort at WSS reform:

1. Involving stakeholders in the design of the reform agenda is essential to build a broad consensus. Reforming a non-performing urban WSS sector often leads to an emotional debate that could rapidly get out of control if not properly framed. A rigorous diagnostic analysis of the current situation should help develop rational arguments to engage into a constructive dialogue with key stakeholders, in particular the likely losers in the reform process, and to address their valid concerns.

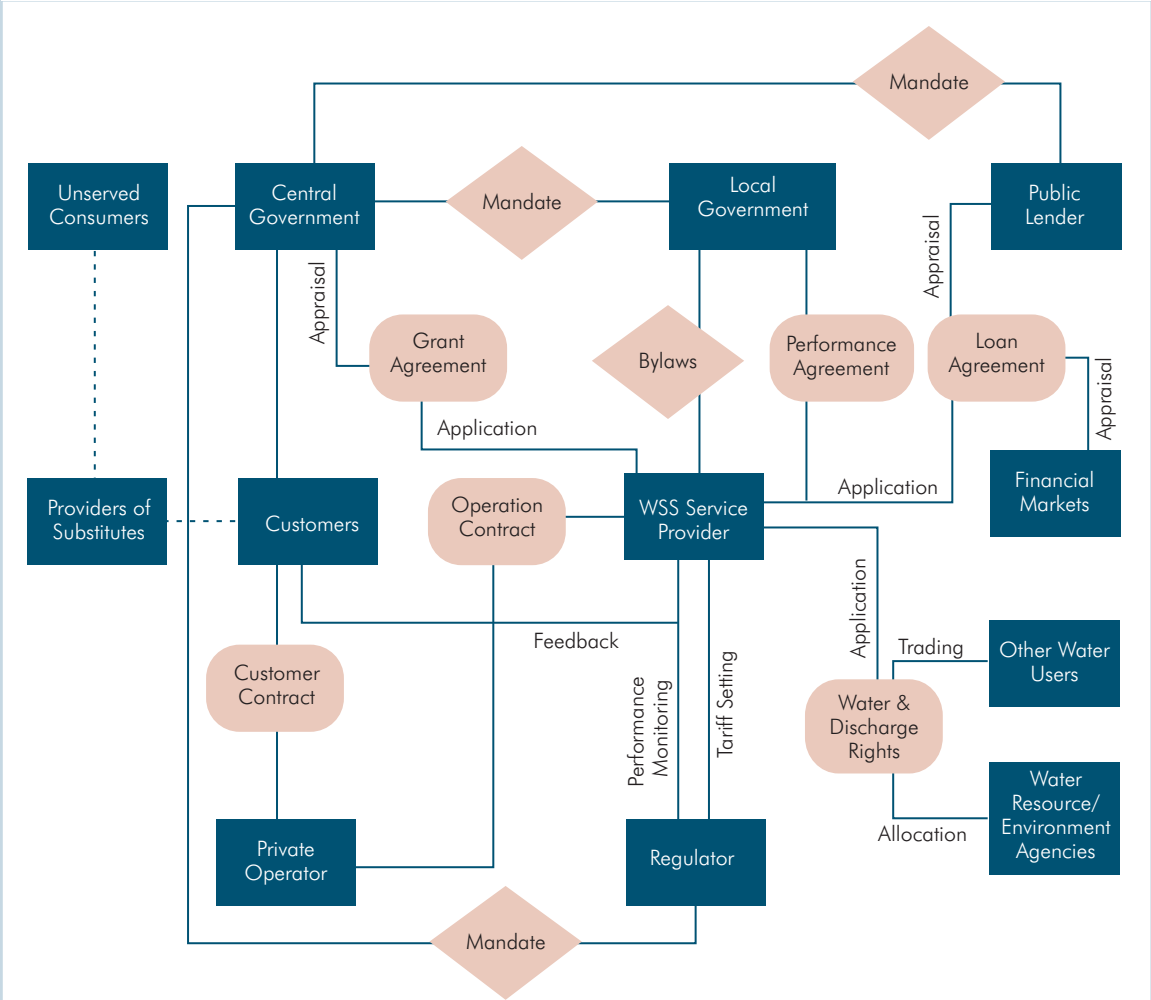
2. Revisiting sector policies provides an opportunity to consider options for sector restructuring, such as decentralizing or aggregating operations, splitting or combining drinking water production, distribution and waste water collection and disposal operations or splitting WSS operations when combined with other network services, such as electricity distribution: thinking outside of the box should be encouraged. Also, water resource management issues that affect the urban WSS service should be clarified, such as the trading water entitlements with other water users or applying standards to effluent quality. The Note recommends that this exercise should also focus on how to provide WSS service for the poor, in particular those living in informal settlements, and regulate provision of substitutes to the piped WSS service.

3. Changing the culture of public WSS service providers can be achieved through a *corporatizing process* advocated by the Note, building on recent World Bank papers on the topic. It also highlights the need for more transparent procedures for the selection and operation of boards of directors and management teams. The Note suggests enhancing accountability of the various actors by establishing contractual relations between: public WSS service providers and the government responsible for this sector; boards of directors and managers; and between managers and staff. The Note also stresses the need for identifying weak links of the accountability framework as they could encourage fraud or corruption.

4. Optimizing infrastructure development is one aspect that needs special attention as significant inefficiencies could result from inadequate demand assessment, planning, design, procurement and project implementation procedures, as well as the diversion of public funds through fraud and corruption. The Note recommends that the responsibility for WSS infrastructure development be vested with corporatized entities that own and maintain WSS assets and are responsible for servicing the debt attached to their expansion as a way for ensuring that development plans meet customer demands and can be afforded by sales revenues.

5. Outsourcing of non-core functions is recommended by the Note when improving WSS

Figure 1. Example of Accountability Framework – Actors, Mandates, Contracts and Instruments



Source: Developed by the authors

service provision through internally developed programs is the preferred option. Enhancing technical operations usually requires a special focus on reducing non-revenue water (NRW) and energy consumption, streamlining procurement procedures, and increasing staff productivity. Improving commercial operations normally necessitates an overhaul of customer relations, metering, and billing and collection procedures. Financial statements and financial management procedures should be independently audited; addressing the qualifications of audit reports should form the basis of financial management improvement programs.

6. Improving the quality of the WSS service and efficiency of operations through public-private partnerships as part of the reform process. PPPs have been the subject of several World Bank Toolkits. The Note discusses key steps

for designing and implementing successful PPPs, the limits of PPPs for raising commercial financing, the optimum allocation of risks and responsibilities between public and private parties, the development of institutions to manage PPPs, and adequate procedures for selecting private operators.

7. Financing WSS operations in a sustainable and affordable manner often requires moving an urban WSS sector from a loss making situation, where user charges are insufficient to cover O&M costs, to a sustainable cost recovery situation where user charges allow coverage of O&M costs, depreciation of assets on a revalued basis, a return on capital sufficient to finance interest on debt and remunerate the equity invested, and a proper mitigation of the foreign exchange risk. Building on several World Bank papers on the topic, the Note discusses ways to ease this transition and points out that mitigating the foreign exchange risk usually requires local capital markets to be able to provide debt in local currency on terms compatible with a sector whose assets are depreciated over long periods, an issue that cannot be addressed solely by improving urban WSS policies.

8. Regulating the service, i.e., setting, monitoring, enforcing and changing the allowed tariffs and service standards, is required to avoid the monopoly abuse of WSS service providers that could provide a bad quality service and charge price above costs to increase their profits or cover their inefficiencies. The Note clarifies that public WSS service providers should be regulated as should private ones. Building on recent World Bank papers, it presents options available for regulating public and private WSS service providers. It also discusses the pros and cons of regulation by contract and regulation by regulator and reminds the key operating principles of a regulator, if created. The Note finally summarizes best practice for setting WSS tariff levels and structures and for designing subsidies that reach those who need them.

9. Prioritizing issues to be addressed when it comes to implementing reforms, the Note stresses, is a key task. It suggests placing particular attention on improving the WSS sector financial situation and on building the autonomy of WSS service providers to move them away from short-term political agendas. It also emphasizes the importance of transferring responsibility for developing the WSS infrastructure to autonomous service providers and for increasing accountability of actors through enforceable contracts. Finally, the Note underscores the need for maintaining the stakeholder consultation process active throughout implementation of the reform, in particular to manage expectations; poorly performing urban WSS sectors cannot be fixed overnight.

The Water Sector Board Practitioner Notes (P-Notes) series is published by the Water Sector Board of the Sustainable Development Network of the World Bank Group. P-Notes are available online at *www.worldbank.org/water*. P-Notes are a synopsis of larger World Bank documents in the water sector.

Water Sector Board

THE WORLD BANK | 1818 H Street, NW | Washington, DC 20433
www.worldbank.org/water | whelpdesk@worldbank.org