Financing water for the world

– an alternative to guaranteed profits

by

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Note: in accordance with our usual practice we use the word 'privatisation' to cover all forms of arrangement whereby the private sector operates the delivery of water or sanitation services to households. This includes management contracts, leases and concessions as well as the anomalous UK sale of assets. The differences between these forms is noted wherever relevant.

1 Preface

Public Services International has sponsored this research because the issue of finance is so crucial to the establishment and delivery of quality public services. This is true for water, for healthcare, for education, justice, roads, and the myriad other public services that many of us, including corporations, take for granted.

The current finance policies in the water sector are dysfunctional. The multilateral finance institutions, such as the World Bank and the regional development banks, heavily favour finance for privatisation. This policy is based more on ideology, on a fundamental belief in the market, and a deep-seated disdain for the public sector. We come to this harsh conclusion because this policy of imposing privatisation through financial leverage has proven to be a dismal failure.

Despite this long record of failure, policy makers at Kyoto will be pressured to place more patches on this failed system. The Camdessus Panel Report proposes a 'Devaluation Liquidity Backstopping Facility' to protect the corporations against currency devaluation, and a 'Revolving Fund' to pay the heavy costs of preparing the terrain for privatisation.

The European Union Water Initiative wants to use official development assistance to encourage private funding – thus northern taxes will pay for corporate profits from developing countries. It also wants to establish a code of practice for privatisation.

These proposals will come to naught because water is unlike any other commodity. For this reason, and because of massive popular resistance, these measures are doomed to fail.

PSI advocates more systematic support to institutions and communities that are responsible for delivery of water services, especially for the poor. These are typically municipal water authorities and rural cooperatives.

Problem for the bankers is that these organisations don't meet in five-star hotels, don't travel the world in first class, don't wear ties and carry briefcases. It is harder to deliver financial support at this level, especially if one is evaluated by the volume of loans one can process. Hence the preference for mega-projects done by mega-corporations based in Europe or the United States.

This research is but one piece in the vast global water puzzle. But it is a crucial piece, and policy makers would do well to consider it very seriously.

Hans Engelberts, PSI General Secretary

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Public Services International (PSI) is a global trade union federation that represents 20 million women and men working in the public services around the world. It has some 600 affiliated unions in almost 150 countries. PSI is an autonomous body, which works in association with federations covering other sectors of the workforce and with the International Confederation of Free Trade Unions (ICFTU). PSI is an officially recognised non-governmental organisation for the public sector within the International Labour Organisation (ILO) and has consultative status with ECOSOC and observer status with other UN bodies such as UNCTAD and UNESCO.

2 Introduction

2.1 Two limited visions for financing water

There are currently two major operations addressing the question of financing the development and extension of water supply and sanitation in developing countries. Both arise out of the commitments made in the Millennium Development Goals (MDGs) –- to halve the proportion of the population of the world without access to safe drinking water and adequate sanitation by 2015.

- The Global Water Partnership and the World Water Council - two international bodies on which the multilateral financial institutions (World Bank and regional development banks) and the multinational water corporations are well represented - set up a "Panel on Water Financing", headed by the former managing director of the International Monetary Fund (IMF), Michel Camdessus. After an 18-month existence, the Camdessus Panel will report its findings to the 3rd World Water Forum in Kyoto in March 2003.

- In parallel, the European Union countries set up their own "Water Initiative" (EUWI), which is also examining the question of financing water in developing countries.

Both of them give a central role to using donor aid to leverage further funds for investment from private sector water companies. The latest EUWI paper on financing[1] aims to *"use official development assistance as a lever for other forms of finance, including user finance and private finance";* the Camdessus Panel recommends stronger guarantee systems for reducing private sector risks, so that the private sector can continue to play a leading role in their development model. Both also give a central role to restructuring water sectors along the French model, to facilitate privatisation; and to full cost recovery.

This paper offers a critique of these approaches. Both EUWI and the Camdessus Panel:

- overestimate the capacity of the private sector;
- ignore the risks for countries in providing guarantees for private concessions or BOTs;
- fail to address the central role of public sector operation and finance, and
- prefer top-down conditionalities to local political decisions on governance issues

Any global initiative should :

- respond to plans which have been developed within the countries themselves;
- provide mechanisms to make finance both easier and cheaper for public sector providers; and
- support redistribution of resources, both nationally and internationally, through public finance mechanisms.

2.2 The relative role of the public and private sectors

Investment in, and operation of, the extended water supply and sanitation systems must come either through the public sector or the private sector – but what does this mean? Both the Camdessus Panel and the EUWI focus heavily on encouraging the private sector. They continue to ignore the reality that the public sector contributes 85% of the finance and operates more than 90% of water systems.

2.2.1 Investment: private contribution is less than 10%

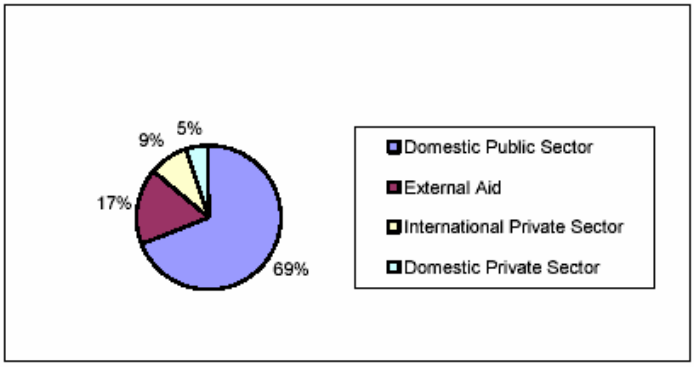
There are a wide range of estimates for the scale of finance for capital investment in water in developing countries, which are discussed by the EUWI finance paper: WaterAid, for example, have made a relatively low estimate of total finance as $27-$30 billion per year. However there is more consensus on the distribution of that finance between public and private sources. The figure below is WaterAid's summary of where this finance comes from, which shows clearly that public sector spending is the dominant form of finance, with donor aid providing about 17%, and the private international sector less than 10%.

There is also a range of estimates for how much investment needs to be increased to meet the MDG targets of halving the proportion without water by 2015, but most expect that it is necessary to double the existing investment – WaterAid for example estimate a further $25 billion is needed per year.

The discussion of how to double financial flows, or leverage extra flows, should be conducted in terms of how to support, stimulate and improve the effectiveness of the greatest source of finance, the public sector.

It is simply not plausible that the international private sector provides the majority of this growth, given it starts from such a low level and has such limitations on risk and profit levels. To generate even half of the extra amount needed would require that the contribution of the international private sector become six times as high as the current level. Yet private finance and investment is declining, not growing. Despite this, both the EUWI and the Camdessus Panel frame their discussion around supporting investment by the international private sector, through creating a conducive, or enabling environment and providing greater guarantees.

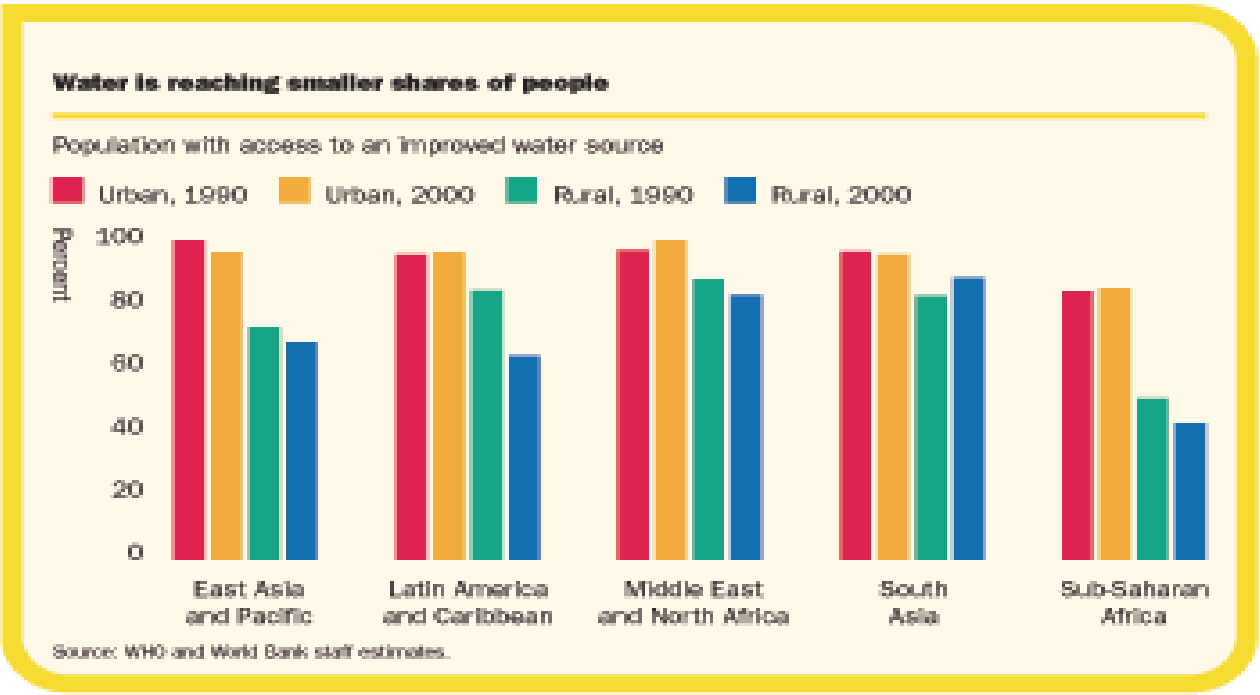
Figure 2.1 Breakdown of current financing to the water sector



Source: Shailaja Annamradju, Belinda Calaguas and Eric Gutierrez, "Financing water and sanitation". http://www.wateraid.org.uk/pdf/financingfinaldraft.pdf

2.2.2 Numbers served: private supply 5% - 7%

The same picture emerges if we consider the estimates of numbers served. The World Bank estimates that the private sector supplies about 5% of those currently receiving a clean water connection – a financial analyst puts the figure at 7% [2]; the other 95%, or 93%, are served by the public sector. To meet the goals by 2015, allowing for population growth, it is estimated that an extra 1.5 billion people will have to be connected to water supply, and 2 billion to sanitation and wastewater treatment. [3] At present, the total served by the private sector, worldwide, is estimated to be around 300 million. The private sector cannot be expected to be the main engine of growth.



3 The limitations of the private companies

3.1 Distortions of public policy – for profits

The Millennium Development Goals are ambitious statements of public policy. Their appeal stems from promising that people will get water supplies who, without the MDG commitments, would not get water supplies. But there are intrinsic problems with constructing a strategy for achieving these goals that relies on the private sector.

Private companies pursue commercial goals, and supplying water and sanitation to the poor is not profitable enough. A business speaker reminded a recent conference in London that no private company will lay a water connection until it can identify a clear stream of revenue to repay the investment. The private water companies will make efforts to structure the public services of water supply and sanitation so as to maximise profit. These strategies may result in less people being connected – for example, a private company will prefer the water supply system to cover only those consumers who can afford to pay the full cost of water, so that their purchasing power is not diminished by being used to cross-subsidise poorer consumers. They may also result in countries paying more – for example, if loan guarantees provided by a government are called on, or if the rate of profit built into a contract is higher than the rate of profit. And they may require the resources of government to be devoted to procedures that would be unnecessary without privatisation,

Aid that is designed to encourage privatised water may thus work against the poor, if it creates structures that are most convenient for private profit, rather than for development objectives, and encourages governments to provide financial support that assures the profits of private companies by placing the risks on the local community.

3.2 Paying for the bureaucracy of privatisation

These limitations appear at the design stage. Both the EUWI and the Camdessus Panel are keen on giving responsibility for water to municipalities, who can then issue concessions, leases or management contracts. But this structure may be at odds with a country's traditions or needs – in central America for example nationally-based water authorities have been more common and effective. These supporters of decentralisation never suggest that the UK, where municipalities play no part at all in the centralised water

system, should be restructured to create decentralised units. If it were restructured like that, companies such as Thames would lose the huge regional monopolies on which their prosperity is based,

A large proportion of all Official Development Assistance (ODA) and international financial institution (IFI) investment in water and sanitation appears to be devoted not to direct investment in water but to the bureaucracy of privatisation. It also distorts the economics of privatisation, because the cost of creating these new administrative systems are not attributed to the private concessions and contracts which emerge from them. This distribution of spending should surely be questioned, not reinforced.

The EUWI finance research (based on OECD DAC figures) suggests that about three-quarters of European Commission aid on water - €168.2m. - goes to support 'water resources policy and administration' – two and a half times as much as on water projects themselves, large and small - €64m.[4] Other ODA – for example USAID spending in southern Africa – is also devoted to administrative initiatives and public relations supporting privatisation.[5] Some World Bank loans also fund administrative restructuring,[6] and there are a number of other programmes, such as the PPIAF which are also concerned with 'creating the right climate' for private investment.[7]

European Commission assistance to the water sector (Overall & Africa), Euros, 2001

DAC Code	Description	Overall
14010	Water resources policy and administration	158,262,731
14020	Water supply and sanitation (large systems)	53,275,718
14030	Water supply and sanitation (small systems)	10,883,533
14040	River development	76,000
14050	Waste management and disposal	1,829,835
		224,327,817

Source: EUWI finance paper

The Camdessus Panel reinforces this distortion in a number of places. For example, it proposes "the creation of a revolving fund to finance the public costs of preparation and restructuring of complex projects, including PSP and other innovative structures. The fund would be used to assist in the preparation and structuring of project bids (including legal, financial and technical advisory costs) at both the tendering and negotiation stage. The funds would be replenished by the authorities once bids were accepted" [8]

Indeed, the Camdessus Panel recommends international expenditure as a matter of urgency on a study "for the preparation of best practice and model clauses in the legal agreements of public-private partnerships….the panel wish to draw the attention of relevant institutions to the urgent need for this initiative".[9]

3.3 The boundary of the profitable

Reliance on the private sector also means that the policy instruments used will only benefit places where the private sector decides it wants to invest – for commercial, not public policy reasons. The boundaries between people who will get connected and those will not, will be drawn by the policies of companies.

One such boundary is the line defining the area covered – for the private sector, it is best to have the most potentially profitable customers, in the cities, separated from the peri-urban and rural areas, to minimise the chance of cross-subsidy (cross-subsidy can mean lost profits). For the peri-urban and rural poor, this makes it more certain that they will not benefit – contrary to public policy. An example of this is Ghana, where a proposed privatisation would separate the capital from the rest of the country for just this reason.

Other boundaries drawn by commercial judgment will also affect who gains from a private-centred policy. Companies may decide to avoid investing in countries, or whole regions – such as sub-Saharan Africa or the newly independent states (NIS) of the former Soviet Union – as a matter of corporate strategy.

Since the key multinationals have now declared that they are reducing their exposure in developing countries below even the existing level, the whole of the developing world now has uncertain status as far as the private sector is concerned. Those elements of the finance strategy aimed at enticing the private sector may at best only slow the withdrawal of the multinationals. (This issue is explored in more detail in the parallel paper on Multinational Water Corporations).

3.3.1 The rural and peri-urban poor: on their own

Most of all, however, a private-centred policy abandons the largest single group of the water-deprived, the rural and peri-urban poor. The World Bank in the 1990s divided the population of the developing world into two groups - the urban populations who would be connected to piped water supplied, profitably, by water multinationals; and the rest, who would not be so supplied, but would rely on self-help, ODA and NGOs acting as providers. This is inherent in World Bank recommendations on pricing and tariffs, which would eliminate the crucial cross-subsidy from urban to rural. The equivalent of such cross-subsidy would instead be directed to corporate profit. The Camdessus Panel appears to have adopted this distinction. The rural poor will get no benefit from private oriented strategies. In fact, the Camdessus Panel recommendations will direct even more ODA to the corporations serving the cities.

3.4 Privatisation risk for countries – renegotiation and cancellation

Even when private companies do move into the water business, they may create more problems than they solve. New papers published by the World Bank explore some of the risks that countries face when dealing with water multinationals. [10]

Firstly, there is the risk of 'unsolicited projects' which the bank describes as some of the most controversial projects in the world, which have a high risk of corruption. This is known to be a problem associated with all forms of public procurement, especially concessions. The two major multinationals which hold over two-thirds of the global market of privatised water operations, Suez and Vivendi, have both had executives of group companies convicted of obtaining water concessions by bribes in France, and, in the case of Vivendi, in Italy and the USA as well. [11] The persistent problem of corruption is one of the main historical reasons why public sector provision has been developed in many sectors.

The Camdessus Panel Report at least acknowledges corruption as a problem, but fail to recognise the economic incentives created by privatisation processes which make corruption an attractive strategy for multinationals negotiating a secure profit stream for 30 years. Urging parties to sign statements of principle is an ineffective counter-weight to the prospect of inflated profit streams for decades to come. The extensive sections on project financing and political risk show no signs of acknowledging that many of the private projects will have been installed by non-transparent agreements with non-democratic and/or corrupt regimes, and deserve to fail.

Secondly, private sector participation (PSP) in water often fails to solve the problems it is expected to resolve, often creates other problems, and is often unpopular.[12] There is a very high chance that the contract will be renegotiated: according to the World Bank's paper, 55 percent of water concessions in Latin America were renegotiated in the 1990s. This is largely due to the corporate strategy of submitting low-cost bids, knowing full well that they will become a monopoly provider, and will have inordinate leverage one or two years into the contract. The Camdessus Report is aware of this issue, and falls back on the vain hope that regulators will be effective in controlling the behaviour of the monopolist corporations.

Thirdly, there is a high risk of cancellation, where the private sector exits the project before the end of the contract. Out of all the water infrastructure projects financed by the World Bank between 1990 and 2001, seven had been cancelled by the end of 2001, representing 11.5% of the total value of water projects. This is a very high percentage, which has certainly grown, as Suez has exited from its Manila concession, and the Argentinean concessions are effectively bankrupt, and Vivendi is being expelled from its major Brazilian contract. At this rate, it now seems a real possibility that none of the 25 and 30-year concessions signed in

the 1990s will ever reach their full time span. Such contract cancellations impose huge costs on the governments, the utilities and the consumers.

4 The expensive risks of relying on private water multinationals

4.1 Tied aid

Policies which impose PSP, privatisation, or market opening are a new version of tied aid. The water sector is dominated, worldwide, by EU multinationals – Suez and Vivendi alone control two-thirds or more of the private market, worldwide, and nearly all the rest is held by RWE-Thames (Germany and UK), and SAUR (France). There is hardly any market share held by local private companies, or even USA-based multinationals. And so the effect of using aid to promote PSP, or requiring privatisation as a condition of aid, is to tie that aid firmly to giving business to EU-based companies. And these are exactly the policy recommendations from the World Bank, the EUWI, the Camdessus Panel, a number of bilateral donors (UK, Germany, Netherlands, France, USA), and for that matter from the GWP and the World Water Council.

There are many local water operators based in developing countries – including large ones, and demonstrably effective ones. Together, they provide water and sanitation services to more than ten times as many people as the EU multinationals. But they are all in the public sector, owned by municipalities or regional or national governments.

A policy which ties aid to privatisation or PSP excludes all of them, all the domestic public water operators in developing countries. In economic terms, and indeed political terms, these policies are thereby using aid to impose European water companies.

4.2 The private sector need for guarantees and subsidies:

Both the Camdessus Panel and the EUWI finance paper acknowledge that the private sector has not invested much and is reluctant to invest because of perceived risk. But it does not convey the problem with the same sharpness as the private sector itself, which insists on public subsidies and guaranteed rates of return as a pre-condition for operating in developing countries.

In January 2002 the World Bank water division was told that the private sector could not deliver for the poor. The speaker was J.F. Talbot, the chief executive of SAUR International, the fourth largest water company in the world. He referred to the huge scale of the needs, acknowledged that the extension of water supply was necessary for sustainable development, but openly asked *"is it a good and attractive business?"*.

The private sector simply does not have the financial capacity: "The scale of the need far out-reaches the financial and risk taking capacities of the private sector." Unlike the EUWI paper, he rejects the possibility of cost recovery from users: *"water pays for water is no longer realistic in developing countries. Even Europe and the US subsidise services… Service users can't pay for the level of investments required, not for social projects…"* [13] The solutions to these problems, in his view, is for public sector subsidies, soft loans and guarantees: *"substantial grants and soft loans are unavoidable to meet required investment levels"* and without these subsidies and soft loans, the multinationals will pull out: *"If it does not happen, the international water companies will end up being forced to stay at home"*.

Vivendi advocated the same position at a conference on water in Africa in 2001, in Kampala. The requirements of low risk and profitability limits investment to '*big cities where the GDP/capita is not too low*.' The prospects of profit depends either on '*…sufficient and assured revenues from the users of the service*' – which excludes the poor - or on government guarantees of payments for the service, in effect subsidies. [14]

The same relentless position from the private sector continues elsewhere. At the IADB meeting with the Camdessus Panel in October 2002, the panellists from the private sector "pointed out that for private investors the two major issues are and will remain: risk and return on investment. Risks must be reduced as much as possible to protect the investment and lower the cost of risk insurance. Return on investment must be realised."

Since the attraction of the private sector is supposed to be its competitive, entrepreneurial attitude, why should they be encouraged into areas where they cannot operate without guarantees and subsidies? The risk for countries in giving guarantees is real (see the parallel paper on Multinationals for details of the problems in Izmit, for example). The Camdessus Panel , however, is simply concerned to reduce the risks for companies. It has little or nothing to say about the risks for countries or municipalities. In fact, the panel's recommendations will expose many more municipalities to risks and impose on them the costs of guarantees to corporations.

5 New financial mechanisms: no use to the public sector

The Camdessus Panel and bilateral donors have proposed a number of financial mechanisms which have some technical attractions but are either limited in the funds they raise, or by their application only to private sector operators. Two recent examples are the IFF and the PIDG.

5.1.1 IFF: bringing forward aid on health and education

The UK Treasury recently outlined a proposal [15] to create an International Finance Facility (IFF), which would be based on long-term (30-year) commitments by donor governments to make annual payments into the fund. The IFF would immediately start issuing bonds to raise more finance in the international capital markets, with the repayment of the bonds being guaranteed by the future flows of aid from the donor countries. The money thus raised would be spent on development projects according to the aid criteria of the donor countries – mostly as grants, but with some concessionary loans.

The IFF has two useful mechanisms. Firstly, it creates a risk-pooling mechanism, so that investors are invited to lend money to the IFF which itself spreads and carries the risk across a multiplicity of projects. Second, it provides security for investors, and the possibility of attractive interest rates, by a guarantee from the donor country governments.

It has however a number of limitations. Firstly, it generates extra funds in the first 15 years by repaying them over the next 15 years – there is no net extra funding over 30 years, just bringing money forward.[16] Second, , it remains a facility for grants made by donors on donors' conditions, not of loans to developing country projects based on financial viability criteria.

5.1.2 PIDG: guarantees and capacity restricted to privatisation

Three donors - the UK, Sweden and Netherlands – are involved in another initiative, involving capacity-building and financial guarantees. The Private Infrastructure Donor Group (PIDG) [17] includes an institution (Devco) which is supposed to work with countries and operators to prepare infrastructure projects, and a company (Guarantco) which would provide guarantees from the UK and Swedish governments for bonds and loans raised by developing countries for investment. The advantages of both mechanisms are clear: they provide technical support at a design stage, and strengthen the appeal of the financial instruments by the guarantees from donor governments.

However the initiative is conceived and structured as a means of supporting business opportunities, [18] and as such, subject to the overriding conditionality of such initiatives, that it is only available to support privatised concessions. It is thus restricted to the 5% covered by the private sector.

5.2 Financing trade or aid?

This is a persistent problem with the current initiatives. The Camdessus Panel and the EUWI clearly see the MDGs as linked to trade policy and the expansion of business opportunities

6 Public sector - finance and operation feasible

Public water supply and sanitation systems serve 90% of the world's population connected to water. The PSIRU booklet 'Water in Public Hands' sets out in detail the evidence that public sector water operators can and do perform effectively and efficiently, and with sound public finances, in developing as well as developed countries. [19]

Public sector water systems can raise funds to finance investment from the same sources as used by corporations. The table below shows a simple categorisation of these sources, which are discussed in more detail in the following sections.

Source of funds	Domestic (inside country)	International
Internal resources	Surplus of operations	
State	Government, national funds	Aid agencies
Bank loans	Domestic banks	International banks
Bonds	Domestic bonds	International bonds
Intermediate funds	Municipal development funds	-
International finance institutions	-	Development banks e.g. World Bank

The one form of finance not used in public sector undertakings is equity finance from private shareholders. However, the high cost of equity finance makes it unattractive as a way of financing water services. In the UK, the private water companies' own advisors are now arguing that water prices could fall by 5 per cent if the industry financed itself purely by debt, instead of the mixture of debt and equity used since privatisation. [20]

Public sector operations may require support in capacity-building. The key element is training, to ensure that the water and sanitation service has a workforce with appropriate skills at all levels, including managerial expertise. This kind of training and development can be carried out without the drastic step of privatising the management or the operation of the water service, by using established public sector companies with no vested interest in recommending privatisation.

This support can be provided through 'public-public partnerships' (PUPs). The partnership is based on a common understanding of public service objectives. The partners may come from within the same country – 'local PUPs' - or from other countries - 'international PUPs'. This kind of partnership has been successfully used in a number of cases and is sometimes known as 'twinning', a common practice for cities.

For PUPs to succeed, many conditions need to exist. PUPs will need the support of the international community, especially if the profit motive is not the driving force. Yet PUPs only get a passing mention of support in the Camdessus Panel documents, and nothing in the EUWI.

7 Water, rights, and solidarity financing

Recent initiatives suggest a different and better way of approaching the question of financing water supplies for the poor – and a way which has a proven success rate.

7.1 UN committee on human rights

In the last week in November, 2002, the UN Committee On Economic, Social And Cultural Rights (CESCR) agreed that the right to water is covered by the convention on human rights.[21]

The CESCR noted that water is a limited natural resource, but that states which are parties to the charter have the duty to progressively realize, without discrimination, the right to water. This right is broadly defined : "The elements of the right to water should be adequate for human dignity, life and health. The adequacy of water should not be interpreted narrowly, by mere reference to volumetric qualities and technologies. Water should be treated as a social and cultural good, and not primarily as an economic commodity."

In saying that water should not be treated "primarily as an economic commodity", the CESCR rejects the approach which treats it as a business opportunity. It also insisted that the right to water is practically achievable|: "Realization of the right should be feasible and practicable, since all States [party to the convention] exercise control over a broad range of resources, including water, technology, financial resources and international assistance".

7.2 South Africa's challenge: regional and global public sector financing

In the same week, Mike Muller of South Africa's Department of Water and Forests (DWAF) made a presentation to the Camdessus Panel on the international financing of water.[22] His analysis of what South Africa has achieved in water was presented in a clear framework of "Social and environmental objectives defined: supported within public finance framework ", summarising that South Africa is "Sustainably implementing 'right to water'" using traditional "redistributive public finance intervention". The point about redistribution is emphasised: "Nationally, Can fund basic and higher needs; Locally, not possible".

He also addressed the limitations of the private sector, including its unpopularity, and suggested that another problem was precisely the endless insistence on PSP: "private role also choked by 'force feeding'. He offered some simple advice: "Drop conditionality of private involvement; Take water services off the GATS table; Focus on providing basic water and sanitation".

He pointed out that South Africa had been able to finance this itself, but that other sub-Saharan African countries would not be able to do so. And he explicitly posed the Camdessus Panel some challenging questions, about the possibility of a "Regional and global public finance approach to achieve Millennium Development Goals". Pointing out that South Africa, after apartheid, found public finance mechanisms to extend services to those previously unserved, he asked: "For the world community:- What is the Global public finance equivalent of ending apartheid?"

8 A way forward

8.1 Local decisions, democracy and knowledge

The first and fundamental step should be to start decision-making from local and national democratic bodies.

The participative budgeting processes of Brazil and India offer examples where plans are developed according to local priorities, reflecting local social, economic and environmental conditions. In India, governance responsibilities are allocated to 'panchayats' and village councils, or to national and regional authorities. Realistic estimates of financial needs can be made, in the context of local resources and needs. The role of banks, international finance, and aid can be fairly evaluated.

Such a process would provide for evidence-based policy-making, in contrast to the current processes. Both EUWI and the Camdessus Panel are examples of global bodies set up by international organisations, constructing solutions form the top down. Neither organisation knows the scale of the problem they are

discussing, except by referring to estimates made by other global bodies such as the GWP or PriceWaterhouseCoopers.

8.2 No privatisation conditionality, no water in GATS

The primary role of the international community should be of solidarity with these local initiatives. There is a model here in the experience in N-E Europe, explored in a parallel paper. But the starting point is to abandon the distortions of conditionalities which impose privatisation..

The Bonn 2001 Freshwater conference agreed that there should be no privatisation conditionality attached to international finance, implicit or explicit, . This means no loans from IFIs, or aid from donor countries, should be conditional upon privatisation – yet the World Bank is actually increasing the proportion of projects which are conditional on water privatisation. [23] Aid should not be used for restructuring the public services so that they are suitable for privatising, or for laying down a prescribed structure for the water and sanitation services of every country. Donors should not attempt to predetermine a role for the private sector , and export credits should not be used as a form of tied aid to induce the commissioning of unsustainable and expensive projects, like the desalination plants promoted by OECD countries in north Africa[24], or destructive and unnecessary dams and engineering projects, like the Lesotho Highlands [25], or even the Cochabamba project[26].

Similarly, the GATS provisions of the WTO operate as a kind of hidden conditionality. The EU is now using them to force countries to open their water systems to private multinational businesses, which is another costly, indirect way of forcing water systems to be restructured for the benefit of international business rather than local citizens. [27] This again leads to sub-optimal decision-making on water systems, skewing structures in favour of commercial operations, even when this undermines public sector provision which may be a better option for the local service. To avoid this distortion, water and sanitation services, and other public services, should be totally excluded from GATS.

8.3 The necessity of cross-subsidy and solidarity

Money may be borrowed in various ways, as discussed, but ultimately has to be repaid. So both current and capital expenditure must be paid for either by prices charged to consumers, or taxpayers, through taxes. Because the poor, by definition, cannot afford to pay much, their needs must be paid for out of higher prices, or taxes paid by others. This is economic solidarity, in the form of cross-subsidy, and is the core of public sector financing of services.

The role of cross-subsidy needs to be accepted as a central necessity for extending water to the poor. Cross-subsidy is needed to finance the capital expenditure needed to make connections, a role which has been provided in most developed countries by capital finance being raised through central governments. But in many areas cross-subsidy will be needed to support even operating and maintenance (O&M) costs. A recent case of municipal boundary re-design in South Africa separated a low-income district from a high-income area – and the low income residents instantly lost the ability to maintain a water supply, because they did not have sufficient local income to meet the O&M costs.

The level of cross-subsidy required to make and sustain connections to the poor should be calculable for any given group, depending on the cost of the technology and its operation, the income of a community, and the local and national tax bases. In some cases, the cross-subsidy may be delivered using the income base spread across a city (e.g. in Porto Alegre) [28], or at national level, e.g. in South Africa.[29] But for the poorest countries, it is likely that the cross-subsidy needed is too great for national tax base alone – and an international cross-subsidy may be needed, which draws money from taxpayers in richer countries.

The total need for cross-subsidies from rich countries is the most precise definition of the sums needed from the international community to deliver clean water supplies to the poor in developing countries. However it is channelled, this cross-subsidy needs to be delivered for as long as necessary to pay for the labour and materials necessary to make the connections and maintain the supply.

The question then becomes one of political commitment and taxation policy. At present such subsidies are raised through general taxation and allocated through aid policies. Other mechanisms suggested are raising a special international tax, such as the Tobin tax, or by making some form of dedicated tax ear-marked for supporting water in developing countries.

These issues have hardly been explored or discussed by the Camdessus Panel, nor by the EUWI.

8.3.1 Create risk-pooling mechanisms for international finance

However the payment system is structured, money will usually have to be borrowed in the first instance to finance the costs of building the water infrastructure. If international borrowing is needed, it then becomes necessary to address the issues which affect the interest rate and availability of funds from international financial investors for the predominant mode of provision, the public sector water companies.

The largest public sector companies in developing countries, such as SABESP in Sao Paulo, Brazil, can borrow directly from these markets, but this is not possible for the vast majority of providers. One useful exercise would be to explore the possibility of creating international risk-pooling funds to enable investors to deal with these pools rather than individual municipalities. Similar intermediary mechanisms at national level have been widely used for financing water by public authorities and public sector utilities, e.g. bond banks, bond pools, revolving loan funds, municipal development funds (MDFs), such as the INCA fund in South Africa. (see 'Water in Public Hands' for more examples and details on such mechanisms). A regional or global version of such a fund could play an important role in facilitating investments in public sector water companies.

8.3.2 Global vacancy – privatisation crowds out ethical investors?

Surprisingly, there seems to be no regional or global equivalents of INCA. For investment funds in rich countries, water utilities in developing countries may be an attractive investment. Pension funds, for example, are attracted by long-term, secure operations such as water utilities which can be used to deliver long-term returns, which match the needs of pension funds very well. For ethical investors, public water supplies in developing countries may be attractive as a positive alternative to arms manufacturers or other traditional investments.

There could thus be an important role for one or more funds which specialise in raising investments and spreading the risk by investing onwards in many public water operations. The absence of such funds may be due to the obsession with privatisation 'crowding out' the possibility of such financial investors. In 2000, at the 2nd World Water Forum, the World Bank called for a fund for investment in water, and one duly appeared – but it invests solely in shares in the water multinationals. It is thus tied to the fortunes of the privateers, and cannot invest in the other 90 percent. So the politics of conditionalities may have hindered the development of market mechanisms which could channel more finance into water supply.

Notes

[1] Department for International Development "Financing the EU Water Initiative" ERM Working paper November 2002. The main activities are summarised in Section 4. This paper includes a repeated invitation to comment on proposals but does not appear to be published anywhere. The version used for reference here is the PDF which was presented by the EUWI to a meeting of the Camdessus Panel in November 2002. It is made available by us on the PSIRU website at http://www.psiru.org/sources/2003/EUWIdraftfinance.pdf.

2 Hans Peter Portner, fund manager at Pictet Bank, as quoted in John Tagliabue, 'As Multinationals Run the Taps, Anger Rises Over Water for Profit', *The New York Times*, August 26, 2002.

[3] See World Bank, Millennium Development Goals, at http://www.developmentgoals.org/Environment.htm.

[4] EUWI Finance paper 2.2.2, table 2.3 and figure 2.3.

[5] For example, USAID spending has gone to help the South African Municipal Infrastructure Investment Unit (MIIU) maintain a pro-private stance in the internal debate on the merits of private sector participation (PSP). Such activities included a USAID funded study tour for South African officials to observe the workings of selected public-private partnerships. See David Hall, "Secret Reports and Public Concerns - a Reply to the USAID Paper on Water Privatisation 'Skeptics'", *PSIRU Reports*, August 2002, pp. 3-4 (http://www.psiru.org/reports/2002-08-W-Skeptics.doc).

[6] For example, in June 1999 the World Bank issued a US$ 30m loan to Argentina, designed to support water reforms in medium-sized cities, including private sector participation in management and operation and the introduction of regulatory structures. See David Hall & Emanuele Lobina, "Water privatisation in Latin America, 2002", *PSIRU Reports*, July 2002, p. 15 (http://www.psiru.org/reports/2002-06-W-Latam.doc).

[7] EUWI finance paper, section 3.

[8] 'Financing Water for All', March 2003, section 5.2.7.

[9] Ibid.

[10] See: John Hodges, "Unsolicited Proposals for Private Infrastructure: Issues", *View Point*, Note No. 255, February 2003 (Washington DC, The World Bank Group) (http://rru.worldbank.org/Documents/Hodges1-022403.pdf); Clive Harris, John Hodges, Michael Schur and Padmesh Shukla, "Infrastructure Projects - A Review of Cancelled Private Projects", *Public Policy for the Private Sector*, Note No. 252, January 2003 (Washington DC, The World Bank Group), (http://rru.worldbank.org/Viewpoint/HTMLNotes/252/252Harri-010303.pdf).

[11] For details, see David Hall, 'The Water multinationals 2002 - financial and other problems', *PSIRU Reports*, August 2002 (http://www.psiru.org/reports/2002-08-W-MNCs.doc).

[12] For a discussion of resistance to privatisation, see David Hall, "Secret Reports and Public Concerns - a Reply to the USAID Paper on Water Privatisation 'Skeptics'", *PSIRU Reports*, August 2002, pp. 3-4 (http://www.psiru.org/reports/2002-08-W-Skeptics.doc).

[13] 'Is the Water Business Really a Business?' Mr J.F.Talbot, CEO Saur International World Bank Water and Sanitation Lecture Series 13th February 2002 http://www.worldbank.org/wbi/B-SPAN/docs/SAUR.pdf

[14] Marie-Marguerite Bourbigot & Yves Picaud, Vivendi Water, 'Public-Private Partnership (PPP) for Municipal Water Services' Regional Conference on The Reform of the Water Supply and Sanitation Sector in Africa, February 2001, Kampala, Uganda.

[15] Treasury/DfID: International Finance Facility. January 2003 http://www.hm-treasury.gov.uk/documents/international_issues/int_gnd_intfinance.cfm.

[16] This pattern is shared by the traditional concession model, or, at a national level, by devices such as the UK's Private Finance Initiative (PFI).

[17] A presentation made in 2002 is available on the World Bank website at http://www.worldbank.org/html/fpd/water/lecture/18.

[18] The report on which the concept was developed was entitled 'Justification and Possible Modus Operandi for Public Sector/Donor Support for the Generation of Business Opportunities in Developing Countries' http://www.cepa.co.uk/docs/Donor%20Support%20to%20promote%20private%20investment%20in%20developing%20countries.pdf.

[19] See David Hall, 'Water in Public Hands: Public sector water management – a necessary option', *PSIRU Reports*, June 2001 (http://www.psiru.org/reports/2001-06-W-public.doc).

[20] Andrew Taylor, "Shareholders could receive Pounds 18bn from utility mutuals – Kelda Water Group Sets Financial Trend", Financial Times, 16 Jun 2000, p. 6.

[21] General Comment on Right to Water (UN Press Release Committee On Economic, Social And Cultural Rights CESCR 29th session 29 November 2002). (http://www.unhchr.ch/huricane/huricane.nsf/view01/B65DC83B73F28AB3C1256C83002B0DAD?opendocument)

[22] Mike Muller, 25 November 2002 : Funding the Water Sector :- A South African Perspective for Camdessus Panel on Financing Water Infrastructure.

[23] 'Promoting privatisation' in 'The Water Barons' by ICIJ. 03/02/03 http://www.icij.org/dtaweb/water/default.aspx?SECTION=ARTICLE&AID=2.

[24] For details, see David Hall, Kate Bayliss and Emanuele Lobina, "Water in Middle East and North Africa (MENA) – trends in investment and privatisation", *PSIRU Reports*, October 2002 (http://www.psiru.org/reports/2002-10-W-Mena.doc).
[25] See David Hall, Kate Bayliss and Emanuele Lobina "Water privatisation in Africa", *PSIRU Reports*, June 2002 (http://www.psiru.org/reports/2002-06-W-Africa.doc).
[26] See Emanuele Lobina, "Cochabamba – water war", *FOCUS on the public services*, Vol. 7, N° 2, June 2000, pp. 5-10 (http://www.psiru.org/reports/Cochabamba.doc).
[27] See "Leaked documents reveal UK Government hypocrisy over trade agreement danger - Activists post confidential EU trade demands on web", *World Development Movement Press Release*, 25 February 2003 (http://www.wdm.org.uk/presrel/current/109gatsleak.htm).
[28] David Hall, Emanuele Lobina, Odete Maria Viero and Hélio Maltz, " Water in Porto Alegre, Brazil – accountable, effective, sustainable and democratic", *PSIRU Reports*, August 2002 (http://www.psiru.org/reports/2002-08-W-dmae.pdf).
[29] Ibid, Mike Muller presentation.