Citizens' Network On Essential Services

Who's Taking Risks?
How the World Bank pushes private infrastructure -- and finds resistance in some surprising places

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Introduction and Summary

Poverty and risk make private investment unappealing where human need is greatest. Investors are staying away from infrastructure projects in developing countries because of limits – both economic and regulatory – on what they can charge for water and power. One response would have been to accept market realities and help governments finance more accountable public utilities. Instead, the World Bank is attempting to rig the game, promoting a range of new instruments – so-called fiscal supports -- to attract private sector participation to risky markets.

Guarantees and subsidies that help to ensure corporate profitability can pose serious risks and costs for taxpayers. They also reveal a double standard: while subsidies for public infrastructure are criticized as financially unsustainable, fiscal supports that prop up risk-averse private providers are touted as innovative solutions for poverty reduction. However, some voices within the World Bank itself, and even the International Monetary Fund, have begun to raise questions about the private provision of networked infrastructure, and openly challenge the appropriateness of fiscal supports for the private sector.

This paper is divided into three parts. Part 1 explores market conditions and government actions that affect the behavior of private infrastructure providers. Part 2 describes the main financial instruments that are used to lure the private sector into markets with poor consumers, and the World Bank's role in developing those instruments. Part 3 identifies highly contradictory positions taken by different actors within the international financial institutions, and reveals the fault lines of an internal debate which has not been resolved.

Part 1: What Turns Off Private Investors?

A. Investors shun the poor

Not many years ago, it was conventional wisdom that private capital would fill huge infrastructure gaps in poor countries. That expectation may help explain the World Bank's erosion in support for sectors so clearly related to poverty reduction. In 2002, its lending for water and sanitation projects was only 25% of its annual average during 1993-97. According the Bank's U.S. Executive Director, Carole Brookins, during the 1990s, the Bank's infrastructure investment lending declined by 50 percent, and even more steeply in the middle-income and European transition countries.[1]

Notwithstanding the World Bank's efforts to bolster the legitimacy of private infrastructure and pressure borrowing governments into adopting it, few private investors are interested. Cheerleaders of market reform have now admitted that the bottomless wellspring of private capital that was expected to rescue poor countries from underinvestment never materialized. From a 1997 peak of US $50 billion, private investment in developing country energy projects dropped to $7 billion in 2002.

In the highly oligopolistic water sector, major firms are fleeing from developing countries, or restricting spending to income generated though user fees. For instance, in 2003 the transnational water firm Suez announced that it would finance its investments in developing countries from cash flow only.[2] The trend toward plummeting investment surprised policy reform champions in the World Bank who, pointing to cash-strapped governments, had argued the private sector was the only viable alternative for financing massive infrastructure projects.

> The shift to the private provision that occurred during the 1990s was much more rapid and widespread than had been anticipated at the start of the decade. By 2001, developing countries had seen over $755 billion of investment flows in nearly 2500 infrastructure projects. However, these flows peaked in 1997, and have fallen more or less steadily ever since. These declines have been accompanied by high profile cancellations or renegotiations of some projects, a reduction in investor appetite for these activities and, in some parts of the world, a shift in public opinion against the private provision of infrastructure services. The current sense of disillusionment stands in stark contrast to what should in retrospect be surprise at the spectacular growth of private infrastructure during the 1990s.[3]

The reasons should have been obvious: poor people mean low profits and high risks. Had privatization enthusiasts at the World Bank actually listened to business executives they wouldn't have been taken by surprise. Water corporations, for example, have been publicly blunt about the prospects for bringing water to the world's poor. In a water policy meeting in Uganda, staff from the French multinational Vivendi stated that the need to make a reasonable profit limits investment to larger cities with sufficient per capital income.[4]

After negotiations for a water concession in Zimbabwe broke down in 1999, a BiWater executive explained: "From a social point of view these kinds of projects are viable, but unfortunately from a private sector point of view that are not."[5] In remarks made to at a 2002 World Bank meeting, the CEO of water multinational Saur openly challenged the "emphasis on unrealistic service

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1 *Transition Newsletter* (World Bank), Volume 14/15, April 2004.
2 Dave Hall, "Water Multinationals in Retreat," Public Services International Research Unit, London, January 2003.
3 Clive Harris, "Private Participation in Infrastructure in Developing Countries: Trends, Impacts and Policy Lessons," World Bank Working Paper No. 5, 2003.
4 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, Kampala Uganda, February 2001 (quoted in Bayliss 2002).
5 Kate Bayliss, "Water privatisation in Sub-Saharan Africa: Progress, problems and policy implications," Presented at Development Studies Association Annual Conference, University of Greenwich, November 2002.

levels [which leads to] limited interest in the market," and concluded that "Service users can't pay for the level of investments required, not for social projects . . . The scale of the need far out-reaches the financial and risk taking capacities of the private sector."[6]

As a former British Environment Minister put it: "Private sector finance will certainly be important but it will generally not be used for basic services . . . private sector investment is at present insignificant at providing basic water and sanitation services to the very people who most need it."[7] Even those who champion private investment have come to the same conclusion: The World Panel on Financing Water Infrastructure, chaired by former IMF Director Michel Camdessus, concedes that, "Compared with other types of infrastructure, the water sector has been the least attractive to private investors . . ."[8]

B. Regulation as a deal-breaker

Water and energy projects require large capital investments that require many years to recover. Corporations want rules that allow them to charge high enough prices to turn a profit, as well as assurances that government won't interfere in their pricing decisions once investments have been made. In other words, they want to ensure that government regulators don't deny them opportunities to make a profit.

The regulatory system determines who shoulders basic kinds of risk in infrastructure projects: design and development; construction; operations (cost overruns, delays), financing (changes in exchange and interest rates), politics (changes in government policy), demand shocks that affect consumption, and the natural environment. Regulations governing these risks can become a major constraint on private sector participation in infrastructure.

In the US, when a utility asks for a tariff increase (to adjust to higher commodity or capital costs, interest rates, inflation, etc), an experienced regulatory commission typically reviews the request at a public forum in which business, consumers, unions and communities may present their own findings and pose questions.[9] In most developing countries, where nothing close to this process exists, regulators have two basic choices for responding to demands for price increases: grant the request, which may be totally unjustified, or deny it, thereby incurring the wrath of the private sector and damaging the "investment climate" that the international development institutions claim poor countries must nurture in order to attract foreign capital.

Notwithstanding cheerful slogans about building "trust" and "partnerships" between business and the state, those who view the question of regulation from the *investor's perspective* are motivated primarily by suspicion and fear. As two World Bank researchers put it: "The key concerns of regulated businesses are whether their assets will be expropriated, whether changes in exogenous

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[6] "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

[7] Michael Meacher, Keynote Speech delivered at International Conference on Freshwater, Bonn, Germany, December 4, 2001.

[8] James Winpenny, *Financing Water for All*, Report of the World Panel on Financing Water Infrastructure, World Water Council and Global Water Partnership, March 2003.

[9] For an in-depth look at this process, see Greg Palast, Jerrold Oppenheim and Theo McGergor, *Democracy and Regulation: How the Public Can Govern Essential Services*. Pluto Press, 2003.

factors will be recognized by the regulator, and how long they will be able to keep the benefits of efficiency improvements."[10] The large capital outlays and long time horizons of infrastructure projects:

> makes investors especially vulnerable to 'opportunistic' government actions. Before the investment is made the government has every reason to undertake to treat the investor fairly, that is to allow cost-covering tariffs and to avoid changing regulation in a way that would adversely affect the investor. Once the investment is made, however, the government (possibly a different one) may be tempted to retreat from its promises, by satisfying political demands to reduce prices or keep them inefficiently [sic] low, or otherwise appropriate the investor's profits . . ."[11]

A recent "Operational Guidance" note on energy sector reform argues that commercial pricing may not be enough to attract investors.

> Even when prices fully reflect costs, additional measures to attract private investment may be required, for example because of uncertainties related to the legal and regulatory environment, or a lack of confidence that government will maintain an agreed regulatory framework. These measures may require governments to share certain risks with the private sector until certain pre-conditions for viability are met, and to provide stronger commitments to agreed contractual and regulatory frameworks.[12]

In the aftermath of numerous utility scandals in rich and poor countries, attention has focused on the need for strong regulation of private providers. However, that very question presupposes that some private provider is willing to operate. Before that can happen, investors must feel assured that regulators will not take the initiative in questioning the price levels they deem "fair and reasonable." As a Harvard University professor explains:

> With a history of state ownership of infrastructure, [developing] countries have not established regulatory bodies that have built a satisfactory reputation with would-be investors [who are] hesitant to submit themselves to an inexperienced and perhaps capricious authority…today the greatest risks for investors appear to be not in outright expropriation, but rather in a slow deterioration of an investor's rights and control. Prices can be regulated, payments for power delayed, and so on.[13]

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[10] Phil Burns and Antonio Estache, "Infrastructure Concessions, Information Flows and Regulatory Risk," *Viewpoint*, Note No. 203, World Bank Group, Finance, Private Sector and Infrastructure Network, December 1999.

[11] Giorgio Sacerdoti, "Sources and Evolution of International Legal Protection for Infrastructure Investment," Paper delivered to conference on Private Infrastructure for Development: Confronting Political and Regulatory Risks, Rome, Italy, 8-10 September, 1999.

[12] "Public and Private Sector Roles in the Supply of Electricity Services: Operational Guidance for World Bank Group Staff," World Bank Group and Mining and Energy Sector Board, February 2004, p. 6. The "Operational Guidance" note on the water sector – ostensibly written by a different author – makes this same point almost verbatim. See "Public and Private Sector Roles in Water Supply and Sanitation Services: Operational Guidance for World Bank Group Staff," World Bank Group and Water Supply and Sanitation Sector Board, April 2004, p. 8.

[13] Louis Wells, "Private Foreign Investment in Infrastructure, Managing Non-Commercial Risk," Paper delivered to conference on Private Infrastructure for Development: Confronting Political and Regulatory Risks, Rome, Italy, 8-10 September, 1999

The significance of the private sector's perspective cannot be over-stated: Among the "greatest risks for investors" is the prospect that "prices can be regulated." The author is obviously alluding to 'opportunistic' regulation – denying the utility the opportunity to make money. However, determining what is appropriate is ultimately subjective and open to interpretation. Moreover, claims about what constitutes a fair price level require a great deal of information.

Unfortunately, private providers have strong natural incentives to limit what regulators know about the utilities they operate. According to a World Bank researcher on infrastructure: "The fundamental problem of regulation is one of asymmetric information between the regulated company and the regulatory agency. The regulated company will have a strong incentive to abuse [its] strategic advantage by under-supplying information or distorting the information supplied."[14] Two other World Bank infrastructure specialists elaborate on this problem by focusing on a specific regulatory task: how to calculate operating costs, which form the basis for setting or changing price levels:

> Regulators cannot directly observe firm-specific information and may find it difficult to build up a reliable picture of firm-specific costs. Bidding documents often cover some of this information, but in most developing countries the private operations will have to revise the forecasts once they get a better idea of the value of the assets. If the regulator uses firm-specific information based on these forecasts, the company may be tempted to change some of its accounting outcomes to affect regulatory behavior.[15]

Given these constraints, privatization advocates recommend some form of "benchmarking" arrangement that enables regulators to compare indirectly the performance of several utilities and detect those charging higher prices than the median. Unfortunately, the effective regulation of what are sometimes called "virtual" companies requires the presence of multiple *and comparable* private utilities under the same regulatory jurisdiction.[16] Because of the constraints on direct and indirect monitoring, when it comes to price-setting, regulators in developing countries who lack the capabilities and laws to obtain, much less analyze vast amounts of complex data, are simply flying blind.

Some privatization proponents regard governments that are unwilling to allow firms to charge higher prices as hopelessly unrealistic. Another World Bank infrastructure specialist finds:

> "There is often a sharp difference between what private companies see as the minimal return necessary to go into business in a risky country and what governments view as an acceptable level of profit . . . (Advisers to developing country governments considering private participation in water will all be familiar with the gasps of disbelief and

[14] Vivian Foster, "Ten Years of Water Service Reform in Latin America: Towards an Anglo-French Model," in P. Seidenstat, D. Haarmeyer and S. Hakim (eds.) *Reinventing Water and Wastewater Systems*, Center for Competitive Government, Temple University, 2003.
[15] Phil Burns and Antonio Estache. "Infrastructure Concessions, Information Flows and Regulatory Risk," *Viewpoint*, Note No. 203. World Bank. December 1999.
[16] See Sanford Berg, "The Art and Science of Benchmarking," Public Utility Research Center, 2003, pp. 3, 7. For a highly sceptical assessment of benchmarking, see Graham Shuttleworth, "Firm-Specific Productive Efficiency: A Response," *The Electricity Journal,* April 2003, p. 50 (quoted in Berg 2003).

> indignation when they first voice assumptions about expected returns on equity.) . . . This is not to say that private companies with a monopoly to supply water services should be allowed to take any level of profit that they choose. But governments should be *realistic* about the profits that they should allow, recognizing the need of their private partners to earn a reasonable return and to be rewarded for the risks that they shoulder."[17]

The problem with such finger-pointing is that it avoids the central problem facing weak regulators; they *don't know* what price is realistic, fair or reasonable. And not surprisingly, ignorance breeds skepticism when powerful and sophisticated corporations ask consumers (or taxpayers) to pay more.

For those whose priority is to help business gain enough confidence to risk their money, there is a simple solution to the risk of government opportunism: *keep regulation weak*. The World Bank's internal "operational guidance" on electricity suggests that when a regulator lacks an established reputation for predictability and being fair to business, "transitional arrangements . . . could include limiting the amount of discretion that regulatory bodies have in setting prices and key parameters…"[18]

Thus, while the World Bank has made sensible public declarations on the importance of strong regulation, and supports a number of capacity-building initiatives for this purpose, its policy advice for its own staff points in a rather different direction. To make sure that regulators don't jeopardize the goodwill of nervous investors, they should be given little authority or decision-making power.

This position poses difficult questions for the Bank's technical assistance and training programs for strengthening regulatory capacity. It is hard to imagine that an institution primarily concerned with maintaining investor confidence would help government develop processes and resources for seriously challenging pricing or investment decisions of private providers, much less for authorizing sanctions for poor performance or contract violations.

Part 2: Fiscal Supports for Private Investors

One of the most common rationalizations for private provision of basic services is that the private sector is better able to manage risk than the government. However, when it comes to capital intensive infrastructure, private firms are so risk-averse that they require explicit guarantees of long-term profitability. There is a range of instruments, often called "fiscal supports" whose explicit purpose is to attract shy capital into risky markets. (See Box 1) Because the y introduce new kinds and new levels of risk into public service deliver, and because World Bank has signalled its intention to "upscale" a number of them, these instruments merit closer scrutiny.

[17] Penelope Brook Cowen. "Getting the Private Sector Involved in Water – What to do in the Poorest of Countries?" *Public Policy for the Private Sector*, Note No. 102. World Bank, 1997.

[18] "Public and Private Sector Roles in the Supply of Electricity Services: Operational Guidance for World Bank Group Staff," World Bank Group and Mining and Energy Sector Board, February 2004, p. 8.

A. Handing over the cash: OBA

Some instruments of fiscal support have been around for a long time. State-funded incentives to attract private firms include "cash contributions during the construction period; subsidies during the operating period, e.g. in the form of non-refundable grants; and a favorable tax regime - including tax holidays, refunding of tax on construction and operating costs."[19] More recently, the World Bank is pioneering "output-based aid" as an instrument to channel pubic resources directly to private firms.

Box 1: Instruments of Fiscal Support

According to World Bank Senior infrastructure economist Timothy Irwin, "When investors are unwilling to undertake a project because of political and regulatory risk, fiscal support may ease those concerns and allow the project to proceed." Irwin identifies six kinds of fiscal support:

Output-Based Cash Subsidies: Perhaps the simplest type of support is to give the private infrastructure firm a cash subsidy . . . The government can also provide voucher-like support to selected customers of private infrastructure services . . . While cash subsidies are not necessarily tied to the provision of certain services, they often are. That is, governments can provide infrastructure subsidies in return for the infrastructure firm's providing, or a customer's purchasing, a certain service. We call these *output-based* subsidies

In-Kind Grants: A government may also make certain resources, such as land and rights-of-way, available at subsidized prices or for no charge at all . . . In the case of privatizations, in-kind grants may extend to selling an entire business at less than its cost [which] In this case, the difference between the cost of the business and its sale price can be considered a subsidy.

Tax Breaks: Private infrastructure investors also lobby governments in the hope of receiving tax breaks, either in the form of reduced tax rates or a temporary "tax holiday."

Capital Contributions: At times, governments *require* private companies to give them partial ownership of the project at no cost, which amounts to a tax. At other times, however, governments may be petitioned to contribute some of the equity . . . capital contributions do not imply a subsidy as such. A subsidy arises, however, when the government makes a contribution without reasonably expecting to receive a return commensurate with the size of the contribution and the risks taken.

Guarantees of Risks Under the Government's Control: Governments are usually asked to assume risks over which they have significant control. Political-and regulatory risks, such as the risk that the government will expropriate assets or keep prices below costs, are the clearest example. There are also less clear-cut cases, for instance the [quasi-commercial] risk that a state-owned electricity utility will default on obligations to pay for electricity it has contracted . . . Another is exchange-rate risk, in particular under regimes in which the rate is ostensibly fixed but may be devalued despite government promises to the contrary.

Guarantees of Risks Not Under the Government's Control: Governments are also often asked to bear important risks over which no one has much control. One example is the risk relating to the strength of future demand for the services provided by a project. The risks created by natural disasters are another. The transfer of risk to the government can be set out in a contract or merely be implicit. That is, governments can sometimes turn out to be bearing certain risks even though they have never explicitly agreed to do so.

Source: Excerpted from Timothy Irwin, "Public Money for Private Infrastructure: Deciding When to Offer Guarantees, Output-Based Subsidies, and Other Fiscal Support," *World Bank Working Paper* No. 10, World Bank, August 2003

[19] Tapping the Private Sector Approaches to Managing Risk in Water and Sanitation David Haarmeyer and Ashoka Mody RMC Discussion Paper 122, World Bank, 1998, p. 13

OBA projects delegate service delivery to "third parties" under contracts that tie provision of financial support to the outputs or services actually delivered. The basic rationale for OBA is that it promotes accountability. A secondary rationale is that it can be used, in principle, to reduce poverty. OBA is not a new invention. The World Bank Group's Private Sector Development Strategy states that OBA projects "are simply variants on concession type arrangements or regulated utilities with the special twist that public funds are used to finance all or part of the payments when agreed results are achieved."[20]

A growing constituency within the World Bank Group seek to use OBA to deliver subsidized services. In a typical scheme involving "lifeline" tariffs, companies would charge poor low-income customers a below-cost rate. To make up the difference, the government would pay the supplier a certain amount for each unit of water sold at this rate. "To receive this output-based payment, the operator would periodically submit billing and collection information (subject to auditing) to the government agency managing the scheme."[21]

Easier said than done. In many borrowing countries, it is considered a major success of reform for the government to simply pay public employees and pensioners on time and in the correct amount. Unfortunately, the regulatory capacity required to implement an output-based subsidy with fairness and accuracy far exceeds that available in most national, much less local governments or developing countries.

At the economic heart of OBA is the performance-based contract (PCB). Extensive experience with PCBs in both the private and public sector illustrates pervasive problems with monitoring performance.[22] Figuring out whether a subcontractor is doing its job well and for the right price is costly and requires technically qualified staff. In other worlds, OBA subsidies aren't likely to work without strong regulation, which is almost invariably absent from borrowing countries. As two management researchers put it: "performance contracts are not self-administering, self-correcting, or self-improving. Performance contracts do not quickly or automatically solve the problems of vendor performance."[23] Former World Bank senior economist David Ellerman puts OBA in historical perspective:

> From time to time, private sector management "discovers" the idea of paying for performance (not just for time put in), of paying for outputs (not just inputs), and of management by objectives accomplished (not just intentions). It all sounds so obvious and so sensible that one must ask "Why didn't people think of this before?" The answer is that they did. And they discovered that it doesn't work too well—aside from fairly rude forms of labor. In areas of human effort where effort, commitment, and the application of intelligence are important, the carrots and sticks of external motivation are insufficient for sustained performance. Beyond simple and specific products, the determinants of quality are rarely susceptible to external monitoring.[24]

[20] World Bank, *Private Sector Development Strategy*, Paragraph 152, 2002.
[21] Philippe Marin Output-Based Aid: Possible Applications in the Design of Water Concessions. World Bank, Washington, DC, 2002, p. 12.
[22] See Elliott Sclar, You Don't Always Get What You Pay For: The Economics of Privatization. Ithaca. Cornell University Press, 2000
[23] Robert Behn and Peter Kant, "Strategies for Avoiding the Pitfalls of Performance Contracting," *Public Productivity & Management R*eview, vol. 22, no. 4, 1999.
[24] David Ellerman,. "From Sowing to Reaping: Improving the Investment Climate(s)" World Bank, 200

OBA also carries risks for financial sustainability. Even OBA advocates within the World Bank recognize the potential for OBA subsidies to distort the fragile budget-making process within developing countries. One Bank economist cautions that: "When the government commits itself to providing subsidies over a long[term] time period, in order, for example, to persuade a firm to make investments in providing the subsidized service, the costs become somewhat harder to estimate and somewhat less likely to be adequately considered."[25] In his own book describing the virtues of OBA, Phillipe Marin explains:

> The ongoing nature of output-based targeted consumption schemes raises difficult issues for sustainability. In most developing countries, vulnerable to periodic macroeconomic shocks and with public budgets under strain, it might be unrealistic to expect long-term fiscal commitments. Moreover, donors might be reluctant to commit to long-term transfers . . . These concerns weight heaviest in the poorest countries, where a large share of the population might be eligible and the scheme could require substantial financing. Since private concessionaires would require credible long-term financial commitments, doubts about the sustainability of such a scheme could limit is application in water concessions for many developing countries.[26]

Ensuring fiscal continuity isn't easy even for wealthy countries. However, OBA arrangements make a steady fiscal stream crucial. Unfortunately, the IMF often insists on austerity measures for controlling inflation or balancing budgets that undermine fiscal continuity. Especially in decentralized countries, when it comes to federal transfers to sub-national governments, IMF conditions on transfer levels, local borrowing limits and central bailouts can become fiscal straightjackets

The increasing enthusiasm for OBA subsidies reveals a disturbing contradiction. The international financial institutions, particularly the IMF and World Bank Group, have berated many governments for failing to cover the costs of services, even when most of users are poor and can't afford commercial pricing. They often insist that borrowers reduce or eliminate subsidies to "loss-making" utilities. The result has been deterioration of quality, which has subsequently been used as the pretext for selling off public services. Yet it now appears that the financial community is conceding that subsidies are, after all, needed to ensure that basic services reach the poor. But while the use of subsidies to support struggling public sector utilities was invariably characterized as fiscally irresponsible, using public resources from the same government to lure hesitant private firms becomes an innovation in development assistance.

B. Taking regulatory discretion off the table

While cash outlays such as OBA and tax breaks can institutionalize corporate welfare, they do have the advantage of being relatively simple to factor into budgets. When a government hands over money for a project or foregoes revenues, it usually knows, more or less, what it's going to cost. This is not the case with a new generation of fiscal supports, which create potential *off-budget liabilities* whose financial impact and timing governments cannot predict. In addition, this new generation of incentives uses formulaic legal arrangements to minimize, and sometimes simply eliminate, the role of domestic regulation in determining the price of services.

[25] Irwin, 2003, p. 16.
[26] Marin, 2002, p. 13.

i. Purchasing agreements

Among the more notorious forms of fiscal support are legally binding contracts that oblige a government utility to purchase private services at a predetermined price over the long term. In the energy sector, a Power Purchasing Agreement (PPA) commits government utilities to buying all of a private generator's output, in hard currency, regardless of changes in demand or fluctuations in the exchange rate.[27] While a PPA is technically a contract of mutual obligation, it can also be understood as an *alternative to regulation* that guarantees profitability. According to a case study of energy sector reform in Bangladesh:

> Private investors that enter into a poorly defined and regulated energy sector often require *supernormal returns* to cover the additional risks they perceive . . . To reduce these risks, government needs to provide contractual obligations that commit the government to ensuring a long-term revenue stream. This is exactly what [was] being done in the Bangladesh power sector through PPA. From a policy perspective, such long term contractual obligations, especially overly-generous ones, are an *inadequate substitute for a proper regulatory structure*. Guarantees also tend to reduce the government's ability to introduce real efficiency into the sector.[28] (emphases added)

Although all the determinants of a fair price cannot be known before a utility concession is awarded, companies understandably prefer contracts that bind governments to a certain price trajectory. As one World Bank researcher explains: "if an electricity-distribution investor's concern is that the government will not allow electricity tariffs to increase as the costs of efficient service provision increase, the government does not have to provide guarantees . . . It can enter into a contract with the investor to allow electricity tariffs to increase according to a formula. That contract *functions as a guarantee*, to the extent that it requires the government either to allow tariffs to increase according to the formula or to pay compensation for breach of contract."[29] (emphasis added) Unfortunately, if subsequent information (or economic shocks) reveals the contract to be a bad deal for consumers or the government, the legal guarantee will trump any regulatory response.

These kinds of guarantees also exist in the water sector, especially through so-called "take or pay" contracts that reduce private sector risks in Build-Operate-Transfer deals.[30] Virtually all risk is transferred to government – and hence taxpayers. Liabilities incurred through such deals can be more onerous than debt, since there is no "re-structuring" process that enables governments to reduce their payments. Recessions, devaluations and unfavourable contractual terms have brought several utilities to the brink of financial collapse.[31]

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[27] Irwin classifies this as "Risks Under the Government's Control." The reason presumably is that government can decide to pay its contractual obligations or not. This underlying notion is quite dangerous, however, since it implies that government can control consumer demand or the value of its own currency.

[28] "Privatization and Restructuring of the Bangladesh Power Sector," Public Utility Research Center, 1999.

[29] Timothy Irwin, "Public Money for Private Infrastructure: Deciding When to Offer Guarantees, Output-Based Subsidies, and Other Fiscal Support," *World Bank Working Paper* No. 10, World Bank, August 2003, p. 25.

[30] See "How many beans make five?" *Global Water Intelligence*, Vol. 5, No. 6, June 2004, p. 5.

[31] See Corral, et.al., "FDI Linkages and Infrastructure: Some Problem Cases in Water and Energy," Public Service International Research Unit, July 2001. For an in-depth study of a highly flawed PPA designed with World Bank

ii. Guarantees

While guarantees traditionally addressed explicit cases of expropriation, such as nationalization of private assets, the new generation covers what has been called "creeping expropriation:" government actions that prevent private providers from making a fair and reasonable return on their investment. Such actions may include mandating lower prices, refusing to authorize price increases, or refusing to proceed with terms of a signed contract, such as paying a company to build and operate a utility, or imposing new quality standards that increase production costs. Other guarantees protect firms from exchange rate risk.

The World Panel on Financing Water Infrastructure, chaired by former IMF Director Michel Camdessus, strongly encouraged the multilateral development banks to use guarantees more aggressively in their efforts to promote private investment in water. The Multilateral Investment Guarantee Association (MIGA) is the World Bank's primary underwriter of guarantees, although the Bank's private sector arm, the International Finance Corporation, has also gotten into the business.

As discussed above, when it comes to rate-setting, there is a fine line between expropriation and legitimate price regulation. For example, in Manila the public regulator authorized the water concession Maynilad, a joint venture including French multinational Suez, to raise prices several times, even though those hikes were not stipulated in the concession contract. It even allowed the firm to automatically pass through certain cost increases directly on the consumer -- hardly an incentive to improve efficiency. Yet when the regulator finally refused to raise rates again in March 2003, the company refused to pay its concession fee, declared the government to be in breach of contract, and threatened to walk away from the utility.[32] Litigation is still ongoing.

In Argentina, following the economic collapse and devaluation of 2002, several private utilities have sued the government for not allowing major price increases in basic services, even though such increases would clearly have negative impacts on a population already devastated by the financial crisis. Most of these cases are based on bilateral investment treaties, under which disputes are settled at the International Center for Settlement of Investment Disputes. According to Arbitration Watch, "of the 63 claims currently pending before ICSID . . . a full 26 of these are against Argentina. And of these claims against Argentina, all but 3 of arbitrations . . . are understood to arise out of damages suffered during the financial crisis."[33]

Most such disputes do not result from brazen expropriation or even mandated price reductions, but rather from the regulator's *refusal to raise prices* to levels demanded by private providers. The perceived need for guarantees in basic services thus arises from a qualitatively different kind of risk than that facing traditional foreign investment in production. The purpose of legal guarantees is not simply to hold on to private assets, but rather to raise prices on services derived

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assistance, see Prayas Energy Group, "The Bujagali Power Purchase Agreement: A Study of Techno-Economic Aspects," Commissioned by International Rivers Network, November 2002.

[32] See Jude Esguerra, "The Corporate Muddle of Manila's Water Concessions," in *New Rules, New Roles: Does PSP Benefit the Poor?* WaterAid and TearFund, 2003.

[33] Luke Eric Peterson, "ICSID sees further investor-state arbitrations registered," Investment Law and Policy Weekly News Bulletin, October 31, 2003.

from public assets. Given the significant off-budget liabilities involved, guarantees could have the effect of quietly micro-managing regulatory decisions, influencing governments to approve even unjustified price increases after perfunctory review.

Part 3: The debate isn't over: IFI perspectives on privatization

The troubling track record of private providers does not prove that government services perform well. Public services are often unaccountable, mismanaged, and fail to reach the poor. But because the failures of private provision are outcomes of structural incentives – that is, natural monopoly combined with profit-maximizing goals -- they must be confronted with real policies, regulations, and credible regulators. This suggests that decision-makers should compare the costs and risks of both approaches to reform, taking into account the institutional environment that exists, to determine which is more plausible to implement, and which developmental goals different reforms address most effectively.

Just a few years ago, it seemed that private provision was the only game in town. Today, however, the development of policy instruments which unambiguously promote a privatization agenda is meeting with some internal scepticism. Listening to the policy "chatter" of the World Bank and other financial institutions reveals a surprising degree of disagreement over how to reform public infrastructure and where to allocate development assistance.

There are certainly those within the World Bank who would value this kind of neutral, ex-ante analysis of trade-offs. However, the sum of individual perspectives has had little collective impact within development institutions. Policy is driven largely by the interests of major shareholder governments, as well as bureaucratic interests of organizations that stand to gain from the adoption of particular kinds of interventions.

A. Privatization: from development paradigm to public relations problem

Privatization has become the most politically explosive economic policy in the developing world. While longstanding controversies like trade liberalization and fiscal austerity still matter, it is privatization -- especially of services traditionally provided by the state – which today often leads to mobilized opposition that can undermine governments' popularity, or even political stability.

Sensing a growing public relations problem, the World Bank has backed away from privatization in public documents and statements. The term itself has almost disappeared from Bank publications, replaced by the more collegial "public-private partnership," or the ambiguous "private sector participation." World Bank vice-president for private sector development Michael Klein declared in 2003, "There was never an actual policy that said you shall privatize everything that moves. But some people interpreted it that way."[34]

According to the World Bank's Research Manager for Public Services, Ritva Reinikka, the controversy over privatization of basic services is "false debate."Having also served as the co-director of the 2004 *World Development Report* "Making Services Work for Poor People,"

[34] Michael Phillips, "The World Bank Wonders About Utility Privatizations," *Wall Street Journal*, July 21, 2003.

Reinikka cares about results. "Instead of getting caught up in the public versus private services argument, the only issue that really matters is whether the mechanism that delivers key services strengthens poor people's ability to monitor and discipline providers, raises their voice in policymaking, and gets them the effective services they need for their families."[35] It's hard to argue with this kind of pragmatism when it comes to delivering essential services that everyone relies on for health, livelihood and dignity.

Unfortunately, that position is not the World Bank's actual policy.

If the institution were truly agnostic about service delivery, then it would help borrowing governments make decisions about reform through an unbiased analysis of costs, risks, feasibility of implementing public and private options.[36] But this is far from the case. The institution is increasingly pressuring governments into adopting unpopular policies.

Part of the reason for the policy's poor reputation is widespread recognition that international development organizations often induce or impose privatization with only a fig leaf of government ownership. In fact, the World Bank has defined ownership as "a concept that denotes a high probability that the policy and institutional changes associated with a lending operation will be adopted and implemented even if there is internal opposition."[37] The Bank continues to insist on private provision through conditions on debt relief or new loans. In many instances, heavily-indebted governments are denied desperately-needed resources until they agree to contract out or award long-term concessions for water and electricity.[38]

The Bank revealed a clear preference for privately-delivered infrastructure with the Private Sector Development strategy, approved in April 2002. Providing a general framework for all of the Bank's sector strategies, the PSD strategy explicitly designates public services like infrastructure, education and health care as "frontier" sectors for private investment.

Like the WTO and IMF, the World Bank identifies firms and non-governmental organizations as "private" providers of infrastructure. The Bank's numerous "Social Funds" underwrite a large and growing portfolio of "Community-Driven Development" (CDD) programs, which typically involve smalls-scale private or NGO service provision. The Bank itself has acknowledged that such programs run parallel to government programs, and that their poor record of sustainability is largely the result of way circumventing local government and national planning processes.[39]

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[35] http://econ.worldbank.org/wdr/wdr2004/

[36] The World Bank and IMF have actually developed an official evaluation instrument, the Poverty and Social Impact Analysis (PSIA), whose purpose is to conduct an ex ante analysis of adjustment programs without preconceived policy conclusions. However, the PSIA has not been used to assess alternatives for reforming public utilities.

[37] See "Adjustment Lending Retrospective: Final Report," World Bank Group, 2001.

[38] ActionAid, *Money Talks: How aid conditions continue to drive utility privatization in poor countries*, 2004; Derek MacCuish, "Water, Land and Labour: The impact of the forced privatization of natural and human resources in vulnerable communities," 2003; Halifax Initiative Coalition; Jessica Woodroffe and Karen Joyner., "Conditions impossible: the real reason for debt relief delays," World Development Movement, 2000. For a critique of IFi conditionality on poverty reduction strategy processes, see Angela Wood, *One step forward, two steps back: Ownership, PRSPs and IFI Conditionality*. World Vision, 2004.

[39] See World Bank Operations Evaluation Department, "Social Funds: A Review of World Bank Experience," Report No. 23668, February 12, 2002, p. 37; World Bank, "Local Development Discussion Paper," Human

Nevertheless, CDD constitutes half of Bank lending to Africa and has become a central pillar of lending programs throughout much of the developing world.

Even the 2004 *World Development Report*, which Reinikka points to as evidence of the Bank's even-handedness, argues that: "There are few advantages to the government's providing the [infrastructure] service itself, which explains why the past decade has seen many privatizations, concessions and the like in water and energy."[40] It's hard to reconcile such dismissive statements with the Reinikka's appealing rhetoric. While the Bank tells the world "we're open to anything that works," its tells borrowing governments something quite different.

The World Bank's "Operational Guidance" for water and sanitation is revealing. It promises that "the Bank Group will work across the full spectrum of public and private options for management and financing." The range of instruments that it identifies includes: "technical assistance, adjustment loans/credits, and investment loans including OBA, Sector-Wide approaches, and local currency financing, as well as IBRD and IDA guarantees, IFC investments and guarantees, and MIGA guarantees."[41]

What is remarkable about the list is that most of the instruments are specifically designed to support *private* provision. Moreover, those that could support public provision in principle rarely do so in practice. A recent comprehensive review of World Bank water and sanitation loans suggests that resources are used overwhelmingly to promote full cost recovery, private sector provision, or both.[42] Notwithstanding the desperate condition of infrastructure in the developing world, and major increases in the World Bank's infrastructure portfolio, major investments to upgrade or expand existing government water services are the exception rather than the rule.

However, that may be about to change. In 2005, public investment in infrastructure is expected to surge. Partly in response to demands made by Brazil and Argentina, the IMF is proposing that fiscal targets should not include spending on certain kinds of public infrastructure. If the proposal is approved, borrowing governments will be able to borrow significant sums for infrastructure without endangering its fiscal balances. This would clearly allow for greater flexibility in water and electricity investment.

However, there is a major caveat. Reflecting the IMF's primary mission of promoting fiscal stability, borrowing governments can only relax budgetary restraints by spending more on *commercially run* infrastructure.[43] What remains unclear is how this condition for greater

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Development, Social Development and Public Sector Management Networks, Prepared for the International Conference on Local Development, Washington DC, 16-18 June 2004.

[40] As indicated above, a more plausible reason for the trend is conditionality. The WDR thus celebrates as common sense the policies that have been imposed on many of the Bank's borrowing members.

[41] "Public and Private Sector Roles in Water Supply and Sanitation Services: Operational Guidance for World Bank Group Staff," World Bank Group and Water Supply and Sanitation Sector Board, April 2004, p. 13.

[42] Sara Grusky and Maj Fiil-Flynn, *Will the World Bank Back Down? Water Privatization in a Climate of Global Protest*, Water For All Program, Public Citizen, 2004.

[43] The IMF acknowledges that determining whether an infrastructure service is commercially run may not be easy. It provides nine criteria to make this determination, which can be aggregated into four basic criteria: managerial independence, governmental relations, financial condition, and governance structure. See International Monetary Fund, "Public Investment and Fiscal Policy," March 12, 2004, p. 22.

infrastructure spending will reduce poverty in countries or localities in which the vast majority of people are poor, and cannot be expected to pay commercial rates for basic services.

For the IMF's new position to bring real benefits to poor people, its fiscal conditions should not restrict spending on basic infrastructure projects that cannot be sustained financially through user fees. Moreover, greater spending flexibility in infrastructure should not be "balanced" through greater austerity in social sectors like health care and education, which have traditionally enjoyed more fiscal leeway. Because "commercial" is now only loosely defined through evolving economic criteria, it will be important to observe the kinds projects, and the degree to which borrowing governments exercise fiscal flexibility in the coming years.

2. "Clearly superior": True believers push privatization incentives

Some public statements from influential World Bank Group organizations and strategic documents reveal a rigid commitment to pursue private provision. According to the IFC's Strategic Initiative for Sub-Saharan Africa, the IFC's

> footprint in Africa will be significantly expand . . . private investment and management are still crucial in achieving efficiency gains, in extending access, in realizing lower costs, and in avoiding the poor governance characteristic of most parastatal utilities. However, new instruments and approaches will be needed to attract this private participation, and it is unlikely to come without some public or donor-provided support. *The outcome will still be clearly superior to continued government ownership and management***.**[44] (Emphasis added.)

The claim, of course, is completely unsubstantiated. Its implicit premise is that government service providers *cannot be reformed* – a notion at odds with the fact that public services routinely improve efficiency and financial footing as a result of reforms that lead up to privatization. It should also be clear that the IFC is far from being a neutral observer on the subject. Indeed, its institutional resources and prestige *depend on the expansion of private services*. It is hard to imagine any evidence that would convince an organization of a policy approach that made itself irrelevant.

Those who work in the business of privatization often reject the very possibility of that their reform might fail. Instead, problems of private provision are interpreted as evidence of how bad public services were before.

> Most problems [with private provision] have been encountered in the electricity and water sectors where this under-pricing was most severe. The last decade showed that private participation was not a panacea, but also that it was not the root cause of these problems. The legally binding contracts and hard budget constraints introduced by private participation flushed into the open problems that had been hidden during the era of public provision. While some governments have not been able to deal successfully with these, these problems will not be solved by a reversion to public provision."[45]

[44] International Finance Corporation, *Strategic Initiative for Sub-Saharan Africa*, World Bank Group, August 6, 2003.
[45] Clive Harris, "Private Participation in Infrastructure in Developing Countries: Trends, Impacts and Policy Lessons," World Bank Working Paper No. 5, 2003. A clue about the professional motivations of the author is his

The statement reveals much more ideology than analysis. Again, its premise is that state-run services cannot be improved, leading directly to advice that public sector reform should not even be attempted. Yet private utility provision is widely associated with problems such as corrupt bidding, "cherry-picking" (providing services only better off customers), excessive rate hikes and contractual disincentives to invest – practices that cannot simply be pinned on previous government providers.

Privatization proponents argue that these problems can be overcome, both through strong regulation and through fiscal supports such as those described in this paper. Yet they are unwilling to compare the costs of those measures, and the risks that they might fail, to alternative proposals for improving the efficiency and accountability of government-delivered services. The World Bank's "operational guidance" for the electricity sector reveals the degree the institution can dismiss any kind of public sector option out of hand:

> In some countries there may be concern that private financing of thermal generation will not be forthcoming, even with substantial support from the Bank group, and that these projects will therefore have to be financed and undertaken by the public sector. Before supporting such a strategy through IDA/IBRD financing, Bank staff should work with the government concerned to undertake a market test to assess whether there is indeed interest from the private sector. This market test would incorporate Bank Group instruments (including IDA/IBRD guarantees, and IFC and MIGA products) built into the tender documents.[46]

What used to be called neoliberal orthodoxy has undergone a profound transformation. Historically one of the central reasons for relying on private capital was the private sector's inherent ability to manage risk better than government. Today, that logic has been flipped on its head: When private investors refuse to operate in an environment in which profit is not guaranteed, *government must offer them significant public resources and assume their risks.*

3. IFI pragmatists rethink privatization, challenge fiscal supports

The international financial institutions continue to argue, as a general rule, that some kind of private sector participation in public services is essential for generating competition and improving efficiency. However, that enthusiasm wanes significantly for natural monopoly sectors such as network utilities, where the potential for competition is restricted. Moreover, research and public statements suggest increasing levels of institutional doubt about fiscal supports. While some privatization proponents are more than willing to use the public purse to attract private sector participation to infrastructure, those who have studied the financial instruments are far more circumspect.

Five years ago, before the Bank had rolled out fiscal supports as a major policy initiative, senior economist Mateen Thobani – a vocal proponent of private sector participation in services -- made a compelling case against using government guarantees

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formal title: Senior Private Sector Development Specialist, Private Provision of Public Services Unit, Private Sector and Infrastructure Network.

[46] "Public and Private Sector Roles in the Supply of Electricity Services: Operational Guidance for World Bank Group Staff," World Bank Group and Mining and Energy Sector Board, February 2004, p. 11.

> against such risks as changes in the political or regulatory climate, breach of contract by state-owned companies, cost overruns, low demand, or fluctuations in currency risk . . . Such guarantees threaten to undermine the benefits of privatization. First, if a government assumes the risk of project failure – for example, by guaranteeing demand for the services to be provided—private investors have little incentive to choose financially sound projects and to manage them efficiently. Second, guarantees may impose excessive costs on the host country's taxpayers or consumers. Because a government's guarantees rarely show up in its accounts or budgets, it may be willing to assume risks that should be borne by investors and may not even know the extent of its exposure. At worst, the issuance of guarantees could lead to a fiscal crisis by encouraging investors to take excessive risks – "heads I win, tails the government loses."

Thobani also opposed insurance against currency fluctuation.

> "There are a number of reasons why investors should bear exchange and interest rate risk. First, government guarantees may encourage investors to take large exposures to exchange and interest rate risks. Then, if a currency depreciates, they could blame the government for their losses instead of recognizing the danger of excessive borrowing in foreign currencies. Second, exchange rate guarantees may have an adverse influence on government behaviour. For example, they might discourage a government from allowing a needed depreciation of the domestic currency following a terms of trade shock. Third, many governments—and taxpayers who support them—may already be exposed to the risks associated with exchange and interest rate shocks. An adverse terms of trade shock, for example, might lead to both a currency depreciation and a decline in incomes, forcing the government to compensate investors just as its tax base is shrinking."[47]

More recently, other IFIs have taken an unambiguously critical posture vis-à-vis fiscal supports and guarantees. According to a water industry newsletter, private sector consultants are complaining that the Asian Development Bank has been advising borrowing governments not to provide guarantees for water projects. "The bank is not shy about it. Asked about the new strategy, Charles Andrews, ADB's principal water specialist (Public Sector Division), explains: 'During the late 1990s BOT stampede, public operators were trampled by BOT proposals. These obligations are contingent liabilities for the contracting government, usually a local government.'"[48]

Such prudence has found its way into official policy statements. In a recent paper, the IMF has called for both caution and fiscal transparency when considering public-private partnerships.

> When considering the PPP option, the government has to compare the cost of public investment and government provision of services with the cost of services provided by a PPP. Since risk transfer is key to increased efficiency of PPPs, the government wants to relieve itself of risks that it perceives the private sector can manage better than the government. To do this, the government needs to price these risks, so that it knows what it has to pay the private sector to assume them.[49]

However, the IMF also notes that fiscal accounting for PPPs is extremely complex and that standards have not yet been developed. As a result, governments will find it "difficult to close

[47] Mateen Thobani, "Private Infrastructure, Public Risk," *Finance & Development*, Vol. 36:1, March 1999.
[48] Frédéric Blanc-Brude, "Thinking Outside the BOT," *Global Water Intelligence*, Vol. 5, No. 6, June 2004.
[49] International Monetary Fund, "Public-Private Partnerships," March 12, 2004, p. 13.

loopholes that enable PPPs to be used to bypass expenditure controls, and to move public investment off budget and debt off the government balance sheet." The Fund concludes that selecting between public and private options "should be based on technically sound value-for-money comparisons. It is particularly important to avoid a possible bias in favor of PPPs simply because they involve private finance."[50] It is significant that in its recent paper "Public Investment and Fiscal Policy," in which the IMF stipulates that greater infrastructure spending applies only to commercially run utilities, it also argues that costs – real or potential -- associated with fiscal supports should be explicitly factored into the budget.

Perhaps the most unequivocal "rethinking" of private infrastructure provision comes from the World Bank itself. In a recent report supervised by some of the institution's most vocal champions of private sector participation as well as respected academics, the Bank concludes that "privatization has been oversold and misunderstood."[51] Walking the thin line between issuing a *mea culpa* and defending its own record, the Bank sustains its general enthusiasm for private sector participation in infrastructure. It finds that the benefits from privatization come primarily from competition. As a result, while "telecommunications offers perhaps the most compelling case for privatization . . . the benefits from privatizing infrastructure monopoly are much smaller than those from introducing competition."

The report also concludes that the most significant challenge in infrastructure reform is adequate regulation, which needs to be established before, not after policy change. In a remarkable display of both policy pragmatism and ideological adherence, the report admits that privatization has often rushed again of the institutional capacity to manage it: "it is important to keep options open—and to delay irreversible changes until their benefits outweigh their potential costs. State ownership may well be undesirable, but at least it retains the option of well-designed future privatization."[52]

One might have hoped that such a report would also have included the option of designing a more efficient and accountable *public* provider. However, given the unflinching support of private provision and relative neglect of regulatory issues that characterized Bank policy just a few years ago, the recommendation to establish a strong regulatory framework before privatizing reflects considerable progress.

Conclusion: Taking Public Sector Reform Seriously

Because the IFIs are likely to permit significantly expanded borrowing for commercialized infrastructure services, the potential for those services to reach the poorest borrowers is an open question. Moreover, while commercialized infrastructure is still mostly under public control, it is often a small step away from becoming privatized. Because the debate over private provision and poverty reduction is by no means resolved, it is essential that decision-makers and citizens ask

[50] Ibid., p. 23, 18.
[51] Ioannis N. Kessides. *Reforming Infrastructure: Privatization, Regulation and Competition*. A World Bank Policy Research Report. 2004.
[52] Ibid., p. 8. The passage apparently refers to infrastructure sectors such as telecoms or electricity generation, whose assets are often owned by private companies. Water systems and resources are almost always under "state ownership," even when controlled by private firms through concessions.

why public resources should ever be used to promote private provision arrangements, especially those that undermine efficiency and put taxpayers at risk.

The main justification might be called the "counterfactual of inaction"—the premise that the public sector cannot be reformed. Yet the fact that public services often become more efficient and financially sustainable as a precondition before privatization suggests that relatively straightforward reforms can and do work for public services: giving the provider more autonomy vis-à-vis elected officials, establishing greater transparency of operational data and decision-making processes, increasing revenues by charging those who can pay, giving workers authority and incentives to make operational decisions, technical upgrading, etc.

In addition, the World Bank's welcomed recommendation that service providers should remain public – at least until public regulatory capacity is in place -- has an important analytical implication. Decision-makers need an analytical tool to assess regulatory capacity. It does little good to call for strong institutions if those who run them cannot evaluate their effectiveness. Such a tool could be extremely valuable for those who wish to understand risks and costs of different options.

Where institutional capacity is simply too weak, regulatory analysis could serve as a reality check that helps government put the breaks on the "irrational exuberance" that sometimes accompanies privatization campaigns. Where regulation can be significantly strengthened, a regulatory assessment may serve as a feasibility study which focuses on two questions: First, when is the public sector ready to govern private provision? Second, which kind of service provision arrangement is the public sector most likely to regulate effectively? In short, by using an ex ante regulatory assessment, governments can make a much more informed choice about when and whether to introduce private provision, and what form of private sector participation the government is best equipped to govern.

Finally, good governance requires more than technical capacity. Greater transparency can make public providers much more accountable. The World Bank itself recognizes the potential of information disclosure to make the governance of public services more responsive to those who use them: for example, it finances performance benchmarking of utilities and "report cards" that make explicit the level of public resources that go to different social and geographic groups. There is also great potential for direct public participation to improve democratic governance of services, especially by giving marginalized people a real voice in decision-making.

These reforms won't achieve results overnight. Creating participatory institutions for public service provision is inherently *political*. The process will take time and cause conflict, and it will not result in perfectly representative governance. However, when poverty and risk make private provision untenable without fiscal supports, decision-makers should take the IMF's fiscal advice and determine how much those incentives will – or could – cost taxpayers over the long term. They should also compare those costs with realistic reform options for improving public provision.

The IMF's concept of "value-for-money" is a useful one, because it allows governments to define their own development priorities, rather than impose a narrow view of effectiveness such as efficiency or profitability. Such an assessment would reject ideological positions. It would focus not only on social goals, but also on practical questions of implementation, including:

- Regulatory capacity. Risky investment environments are usually characterized by weak (or absent) regulators. Is the same government that is asked to provide resources to support private profit levels likely to negotiate "the best deal" for users? Will it have the oversight and authority necessary to ensure that the provider achieves equity and efficiency goals?

- Costs. Subsidizing poor people or expanding the network under government provision entails real costs, but these can be measured with some degree of precision, and adjusted if expectations are invalid. Many of the costs associated with attracting private provision attractive are "off-budget" or contingent on specific events. Which option involves more "up-front" costs, and how much could contingent costs add to fiscal stress? Given the inevitability of "learning by doing" under any kind of reform, what are the costs of making mistakes, and how long are those costs likely to be borne? Under private contracts, can provisions based on misjudgements or inaccurate information be reversed at all?

- Country "ownership." Experience with policy-making suggests that political legitimacy, which is derived from genuine country ownership, can be even more important to sustaining reforms than technical design or financial resources. Given an open and public dialogue about distinct choices for reforming utilities, which enjoys more home-grown support among constituents that matter to government?

The purpose of asking these questions before adopting policies to reform utility services is not to rule out the possibility of private provision. Indeed, in the event that government ultimately chooses private provision, the very act of conducting such an assessment is likely to improve contractual provisions, the regulatory framework and popular support. But by explicitly assessing the costs and risks fiscal supports, government and citizens can put the option of public sector reform back on the table.