



## Water and Sanitation Program

An international partnership to help the poor gain sustained access to improved water supply and sanitation services

# Private Sector Participation in Urban Water and Sanitation Managing the Process and Regulating the Sector

December 5-6, 2001 • Manesar, Haryana, India

# Nagari

## South Asia Region



**Urban Think Tank**  
Water and Sanitation Program – South Asia

## Thirteenth Meeting of the Urban Think Tank



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Ministry of Urban Development and Poverty Alleviation, Govt. of India



**WORLD BANK INSTITUTE**

## How Private Sector Involvement can Help the Poor: Lessons from Manila (East)

 Contrary to popular belief, the private sector is well placed, willing and technically capable of providing services to poor communities at a price they can afford to pay. A good example of this is the *Tubig para sa Barangay* (Water for the Village), an initiative undertaken by the Manila Water Company, the private operator in the East Manila concession, to provide affordable service to the poor.

Significant portions of Metro Manila's poor residents still depend on vended water, which costs between 15 to 20 times more than piped water. *Tubig para sa Barangay* is an innovative scheme, introduced to provide legal water connections to poor communities who live in crowded, densely populated areas where it is often difficult to install conventional water pipes. This program was not part of the original contract but was undertaken after joint discussions between the regulator and the concessionaire and in response to a perceived need. The concessionaire came up with the idea of putting in banks of meters, from where families who wanted a private connection could install and run a rubber piping connection to their own home. A meter is provided for each private connection and cluster meters and bulk meters are

also available in some areas. Community workers, NGOs and political leaders all helped to generate support for this program at the *barangay* level, which is the smallest political unit in the city.

Since 1997 *Tubig para sa Barangay* has benefited nearly 35,000 households; this excellent community partnership has improved the quality of life for many poor consumers by providing them with clean piped water at an affordable price. At the same time illegal connections, leaks and unaccounted for water have been minimized. While it generates support for reforms among poor communities, it also broadens the customer base and increases the revenue of the private operator. Interestingly, it has reduced traffic congestion in crowded areas, as the water vending tricycles which used to block roads as they stopped intermittently to provide water to customers are now disappearing from the streets.

*Tubig para sa Barangay* clearly demonstrates a win-win outcome where the concerns of the poor have been met with better service, lower bills and improved health, while private sector expertise and investment have been able to bring about improvements for the city as a whole.



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LdE

## FOREWORD

by Kosal Ram  
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**India's** rapidly growing towns and cities house 28 percent of the population, of whom 70 million are poor, contribute over 50 percent of the country's GDP, and suffer from increasingly inadequate public services. All consumers suffer, but the poor bear a disproportionate share of the costs of coping; this impacts seriously on their welfare and their ability to rid themselves of a life of poverty.

In this context, India's economic growth and levels of poverty are increasingly being determined by the productivity of its towns and cities. This potential of the urban sector to contribute to national welfare requires, among other factors, adequate infrastructure services for generating economic growth and reducing poverty. Current public institutions do not have the financial and human resources to bridge the infrastructure gap and meet this challenge. It has therefore become necessary to involve the private sector in service provision.

The water and sanitation sector has not been immune from the daunting challenges of service delivery facing the urban sector in general. Cities in India do not supply water 24 hours a day, seven days a week; the poor are often excluded from formal

service provision; and we have not broken the cycle of water-borne health problems. The urban water sector needs urgent attention and here, too, the role of the private sector needs to be explored.

Drawing on international experience, the Ministry of Urban Development and Poverty Alleviation (MoUD & PA) intends to support new policy initiatives to address the service challenge in the urban sector. This includes promoting public-private partnerships to create an enabling environment for institutional reforms. This workshop is part of such an overall process to support our efforts. The focus will be on the urban water sector and ways that private sector participation (PSP) arrangements can contribute to making the sector more efficient while serving the poor. I hope this workshop will help inform our reform process by addressing these questions:

- What are the options for structuring the urban water market and industry by involving the private sector?
- How can policies and institutions be designed for a sector that is in transition?
- What kind of regulatory framework is appropriate for a large country such as India and with responsibilities for infrastructure services allocated between different tiers of governments?
- How can poor people benefit from private sector participation?
- What lessons can be drawn from reform in the electricity sector?

### GUIDELINES FOR PRIVATE SECTOR PARTICIPATION IN URBAN WATER AND SANITATION SERVICES

The Manesar Workshop was the launch pad for the MoUD & PA's initiative to formulate guidelines, which will act as a useful tool for those Municipalities and States who are serious about reform, to design a program which suits their situation, is attractive to private partners and, most crucially, improves the state of water supply and sanitation services in India, for all consumers, but especially for that most neglected group, the urban poor.

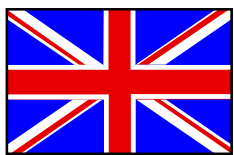
As a follow-up to the workshop, the Ministry held formal consultations in February 2002, to decide on the structure and key issues to be covered by the guidelines; and in June to solicit feedback on key recommendations contained in the draft guidelines. These consultations were attended by State and city officials responsible for urban and water sectors, service providers, independent consultants, and representatives of consumer groups, research organizations, international financial institutions, and bilateral donors.

With assistance from the WSP-SA, the MoUD & PA will disseminate draft guidelines and continue consultations at the State level. The Ministry is also gearing up to respond to requests from individual States and urban authorities to assist in the design and implementation of their reform and private sector participation programs.

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## International Experiences: PSP Around the Globe

### England and Wales, UK



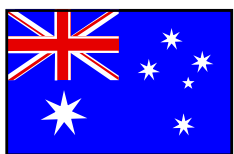
**Privatization** of water and sanitation services in England and Wales took place in two phases. In 1974, 10 regional public Water and Sanitation Authorities, and 29 statutory water-only companies, were created. Full asset sale followed in 1989 as part of the Governments' wider privatization policy. The process included writing off industry debts of £4.9 billion and providing government cash injection of over £1.5 billion. The UK Government held a 'golden share' for the first five years, enabling it to maintain a controlling interest in each company. Twelve years after privatization, there are 10 regional water and sewerage companies and 14 water-only companies operating in England and Wales. Their licenses are for a minimum of 25 years with a 10-year notice of termination.

Economic regulation is provided through an independent statutory body, OFWAT (The Office of Water Services); a price cap regulation mechanism sets tariffs, monitors inputs and outputs, and benchmarks efficiency to put competitive pressure on the utilities to improve their performance. The Drinking Water Inspectorate monitors water quality. The Environment Agency is responsible for environmental issues of service provision.

Since privatization, over £50 billion have been invested to improve quality and service standards. Total operating costs decreased by 12 percent in real terms between 1992-99. There are special arrangements and subsidies for low-income customers and, while disconnection of service for non-payment of bills by domestic consumers is not allowed, other legal provisions exist to ensure payment.

*For more information, contact: Tony Ballance, Former Chief Economist, OFWAT, UK*

### Adelaide, Australia



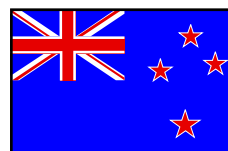
**Against** a background of rising public interest in Private Sector Partnerships the State of South Australia decided to seek private sector involvement in management of the water and sanitation services in Adelaide. The entire process, from initial expressions of interest to commencement of the contract in 1996, was completed in 12 months. United Water, a consortium of three private companies, was awarded the contract to manage, operate, and maintain Adelaide's water and wastewater infrastructure serving over 1.2

million customers in an area of 1,600 km<sup>2</sup>. In consultation with the unions, a labor policy was agreed which allowed employees to choose one of four options: to remain with the State utility (if a position was available); join United Water (if qualified); be redeployed in other government departments; or take a voluntary retirement package.

The State utility remains responsible for regulation, billing and collection, bulk water supply and capital investments. The 15-year contract is highly prescriptive, an arrangement which facilitates regulation by contract. Payment to United Water is part-fixed and part-variable, depending on stringent performance criteria such as water quality, network services and effluent quality. Operating costs have fallen by 20 percent since 1996. Concessions are given to pensioners and United Water has introduced special payment plans for customers facing financial difficulties.

*For more information, contact: Martin Kennedy, Network Manager, United Water International*

### Papakura, Auckland, New Zealand



**In 1997**, the Council of Papakura District in the city of Auckland awarded a 30-year lease contract franchise, with a further 20-year option, to United Water. This provides for revenue collection, and maintenance and operation of all network services, for a population of 40,000 people. Regulation is by contract, one condition of which is that tariffs in Papakura District must be lower than the average rate for Auckland City. The contract provides for cost recovery, plus return on investment, to United Water. Prices, which are usage-based, were frozen for the first two years of the contract. Three-quarters of the public utility employees were absorbed by the private operator, a move that created new job opportunities within the District Council, which continues to have responsibility for bulk water supply and treatment, and for tariff setting.

This lease contract arrangement allows the Council to access the latest technology and expertise and releases capital for other projects. An independently audited asset inventory and condition assessment is required every five years. United Water has prepared plans for asset management, drought contingency, and disaster recovery and, following consultations with a wide customer base, has developed a Customer Charter. United Water is willing to reschedule, or defer payments, for customers facing difficulties meeting their bills.

*For more information, contact: Martin Kennedy, Network Manager, United Water International*

## Johannesburg, South Africa



**In 1998**, struggling with a rundown infrastructure and unprecedented financial problems, the city of Johannesburg

embarked on a radical restructuring of municipal services. A single, centralized city management unit assumed overall authority but public services, including water and sanitation, were decentralized into different types of public/private sector partnerships. Recognizing that city restructuring had a national dimension, the central government contributed Rand 15 million towards the cost of institutional restructuring. Pre-PSP initiatives for water and sanitation services included enabling legislation for local authorities, intensive consultation with customers, and good communications with employees, unions, State and national government, and businesses. A Contract Management Unit (CMU) was established to negotiate contracts with the private sector, and to oversee the functioning of the public utilities.

A service delivery agreement was signed between the City Council and the newly corporatized public utility, Johannesburg Water; in 2001 Johannesburg Water awarded a five-year management contract to a private consortium led by Northumbrian Water Group and Suez Lyonnaise des Eaux. The contract covers delivery, customer service, operation and maintenance, and human resources development (HRD) within the public utility. The private operator has filled key managerial positions at Johannesburg Water and carries out service delivery using employees of the public utility, who were given an initial three-year job guarantee. Payment to the private operator is part-fixed and part-variable, and includes incentives to reduce sewer overflows, improve water service and strengthen human resources. Pro-poor measures include: 6 kl per month of water provided free to every household; water tanker delivery to unconnected communities; and, lower tariffs for low volume usage.

**For more information, contact: Prem Govender  
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## Gdansk, Poland



**This** city provides an example of a joint venture (JV) lease contract in which the shareholding in the service providing company

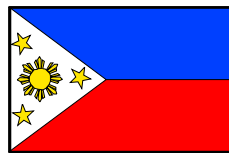
is split 51/49 between the private company, SAUR International, and the city government; the JV is known as SAUR Neptun Gdansk. Regulation is by contract. The city government is responsible for decisions on investments and tariffs; the JV operator provides all network services and handles customer

relations. There were no redundancies under the new arrangements; salaries exceed the national average, and there are performance incentives as well as training and career opportunities.

Although there was very little baseline information available to the private company when the contract was signed, service standards have improved and now meet European Union specifications. The tariff in Gdansk remains lower than the national average across all urban areas, but it has been increasing from 3-10 percent per annum. As a result of using price as an effective management tool, the per capita demand for water is down by almost 50 percent to 120 liters a day, while service standards have improved. The city provides a direct payment subsidy for poor consumers and lower tariffs are on offer for low volume consumers.

**For more information, contact: Gerard Boulle,  
President, SAUR Polska**

## Manila, Philippines



**The** decision to involve the private sector in improving the quality and efficiency of water and sanitation services in

Manila was taken in response to public demand and in the light of the perceived success of PSP in the power sector. The Metro-Manila area, serving a population of about 11 million people living in eight cities and 20 municipalities, was divided into two service zones, East and West Manila. After a two-year process, concessions were granted to two consortia of international and domestic companies. Manila Water Company was awarded the contract for the East Zone and Maynilad Water Services the West Zone. There was full transfer of operational responsibility and capital expenditure, including servicing of a US\$1.2 billion debt, to the concessionaires. The public utility Metro Manila Waterworks and Sewerage System (MWSS) has retained ownership of all assets and are responsible for supplying raw bulk water. Following extensive consultations with employees, voluntary retirement programs reduced the workforce by nearly 40 percent at a cost, to the Government, of only US\$44 million.

The concession agreement is performance-driven and simple to monitor. A quasi-independent regulator has been placed within the public utility. The regulatory office is responsible for monitoring compliance with contractual service obligations and determining extraordinary price adjustments, rate rebasing, early termination and penalty assessments. In addition, a Public Performance Assessment Project has been set up to provide reliable, independent feedback on service performance.

After three years of PSP, tangible benefits from the private operations in the city include: investments of more than US\$250 million; water service coverage increased from 67 percent to 80 percent; direct connections benefiting one million urban poor who pay a unit cost of 6-12 times less than before; increased productivity; and, increased tax revenues for the Government. At the start of the concession, the tariff charged by the private companies was well below the rate levied by the public utility; but tariff rates are now rising, partly as a result of the adverse effect of the peso devaluation on servicing the inherited debt commitment.

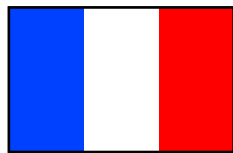
**For more information, contact: Mark Dumol, Former Chief of Staff to the Secretary of the Department of Public Works and Highways, Manila; Rex V. Tantiongco, Former Chief Regulator, Manila; Virgilio C. Rivera, Director Regulatory Affairs and Corporate Planning, Manila Water Company**

form associations to achieve economies of scale; about 15,500 water undertakings cover nearly 35,000 municipalities, most of which are rural. Most associations are voluntary and municipalities come together under common Articles of Association to form a regional utility. Assets and operational responsibilities are transferred to this regional entity. A Prefect or State Representative arbitrates in the event of a dispute.

About 80 percent of water services and 55 percent of sanitation services are provided by the private sector. PSP takes place through delegation of responsibility as the 'public service' definition of this sector forbids outright sale or joint ownership. In a highly decentralized system of local governments, the Mayor signs and regulates the contract. S/he must produce an annual report on tariffs and quality of service and regional audit offices conduct financial monitoring. A national 'sunshine regulator' will be set up to advise local governments on management of private contracts. Following the principle of 'water must pay for water', there is a move towards full recovery of O&M costs, but some subsidies, from local and central government, remain in place and are used to finance investment and capital costs.

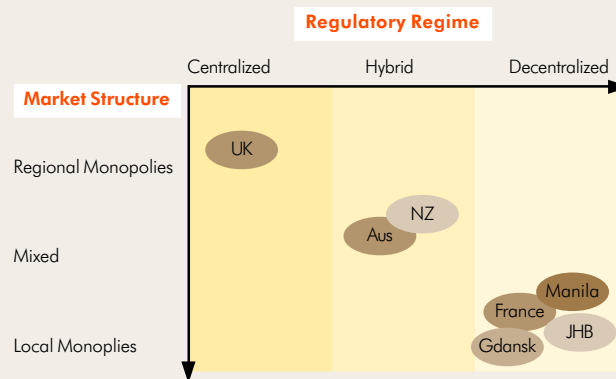
**For more information, contact: Sophie Tremolet, Senior Consultant, Environmental Resources Management, UK**

## France



**France** presents a variety of institutional arrangements for large cities and voluntary clustered associations of small towns and villages. Small municipalities often

**Figure 1**



Provision of water supply and sanitation (WSS) usually takes place in a localized monopoly market structure due to the network nature of infrastructure, although the private service provider is selected through a process of competitive bidding. However, international experiences of PSP clearly indicate that there is a wide range of arrangements for public-private responsibilities, as well as market and regulatory structures. The UK has a system of regional companies, which are in effect monopolies within their jurisdictions; Australia and France adopt a mixed approach with both regional and city-level monopolies; Adelaide, Johannesburg and Gdansk have city-level monopolies; and Papakura and Manila have sub-city monopolies. There is a clear link between diverse market structures and counterpart regulatory systems. The UK has a single regulator for the entire country; France has a decentralized system with municipalities regulating via individual contracts, but there is a proposal to appoint a national regulator operating in an advisory capacity; Manila and Johannesburg have a decentralized system with an exclusive regulator responsible for each city. Figure 1 depicts the range of market structures and regulatory regimes described above. The greater the number of localized monopolies, the greater the possibility of adding benchmarking as an additional instrument of regulation.

## PSP and the Poor

In many developing countries the poor are likely to comprise the majority of potential new customers, demanding better services for reasons of health, hygiene and convenience. However, many of the reform measures which are suggested to achieve a better service for the poor – more cost recovery, less tolerance of illegal connections, and private sector participation – are perceived by some groups as being inimical to poor consumers. In fact, many of these reform measures can work to the advantage of the poor, where they are specifically designed to do so by addressing their needs in contracts and regulatory arrangements. As the matrix of international experiences indicates, well-designed public-private partnerships can embrace effective pro-poor measures.

- **Service Coverage.** Mandatory to provide 100 percent service coverage, a target that necessarily includes poor consumers. In developed countries, where networks are already pretty much in place, 100 percent coverage poses little problem. However, examples from developing countries, namely Johannesburg and Manila, indicate that agreements with private operators should specify a time frame within which the goal of 100 percent coverage has to be achieved.

- **Cross subsidy and pricing.** Almost all the cases presented, irrespective of whether countries are developed or developing, include provisions for helping poor consumers – for example, reduced tariffs for the poor and low volume users, deferment of payment for those not able to pay on time, and non-disconnection clauses for domestic consumers.

- **Service quality.** While contracts in developed countries specify universal standards for all consumers, the needs of poor consumers can also be met by allowing for variations in service quality and innovative design of the delivery mechanism. Case studies in Manila and Johannesburg illustrate that hand pumps, tanker water or rubber piping can provide safe, affordable water to meet the needs of unserved communities in the short to medium term.

Enhancing efficiency/appropriate pricing and providing services to the poor need not be mutually exclusive objectives. Pricing can be an effective mechanism for ensuring the poor have better access to services, and efficient revenue generation can fund an expanded service network which could help to cross-subsidize poor consumers. But clearly, unless services are working well overall, it will be hard to make services work for poor people. Institutional reform of WSS is necessary to ensure that poor people benefit from improved, and more reliable services.



For more information on pro-poor design, see 'New Designs for Water and Sanitation Transactions: Making Private Sector Participation Work for the Poor', WSP and PPIAF, May 2002

## Emerging Issues and Lessons for India

The diverse international experiences shared at the workshop raised some interesting issues, and helped to draw some lessons, for those Indian towns and cities determined to improve water and sanitation services through larger scale partnerships with the private sector. What steps need to be taken prior to any PSP transaction? What kind of regulatory framework might suit the Indian situation? How can this process be managed? Can poor consumers benefit from PSP? Summarized below are some of the key issues and lessons that emerged during the workshop.

### Creating the right conditions through pre-PSP structuring

The international examples highlighted the need for preliminary re-structuring measures to create the enabling environment for a successful large-scale PSP launch. These should include:

- Ring fencing the fixed assets, finances, and human resources of each public utility to create the legal and corporate standing necessary to do business with a private company.
- Clearly identifying, and providing separate accounts for, all major functions such as bulk water transmission, treatment plants, network and customer services, billing and collection.
- Developing a rehabilitation/expansion plan linking service improvement targets to operational and capital costs; and outlining the roles of policy-makers, regulators, asset owners and private partners in implementing this plan.
- Creating a legislative framework which empowers relevant authorities to develop PSP partnerships without political interference; is consistent with Indian laws; supports a strong regulatory mechanism; enables financial and institutional restructuring where necessary; and facilitates sensible multi-town 'pooling' of WSS assets.
- Taking a strong line on cost-recovery to address tariffs, which are significantly lower in India

than in most other countries and rarely cover the cost of services. A phased approach to tariff increases, in the pre-PSP period, may be necessary. A clear position needs to be taken on extending subsidies to poor consumers; this includes subsidy design, financing and targeting.

- Developing a labor strategy in consultation with unions and private operators, to address the fear of large-scale redundancies. Almost all the international cases presented included a well-considered labor strategy as an integral part of the PSP process.
- Financing the transition to an efficient water system may require upfront fiscal commitments. The Government of India's 'City Challenge Fund' provides such a facility for cities.

### Getting the regulation right

The need for regulation of WSS was unanimously accepted. It was also agreed that the regulatory body should be autonomous and separate from the service provider or the policy-making authorities. The following considerations are among those which would need to be borne in mind when taking a decision on the kind of regulatory mechanisms suitable for India.

- Given the federal nature and size of the country, and because water is a State subject under the Constitution of India, the regulatory body could be established at the State or city level. Initially the regulator could be responsible for the city or a cluster of towns, and a State-level regulatory body could be set up as PSP spreads to more towns and cities across the State.
- Placing the WSS sector regulator within another existing regulatory office, such as electricity or telecommunications, is also a possible option in the initial stage, both for reducing costs and gradually creating capacity for exclusive WSS regulation through a separate body. But this depends on the credibility of the existing agency.
- Developing a regulatory mechanism, either before or alongside PSP, would send serious signals about the determination to bring in institutional reforms and proceed with the process.
- A regulator would set tariffs, enforce performance targets, protect the interest of consumers – including the poor – and ensure that income was sufficient to cover operating costs and provide a reasonable profit/return on investment for the private operator.
- A city-level regulator would most likely regulate by contract. A State-level regulator could also have additional responsibilities, such as benchmarking costs and performance, disseminating best practices and resolving contract disputes across the State.



Indo-USAID FIRE-D Project





- Building regulatory capacity and developing a financial and technical database for competent regulation will require time and patience. Transitional steps such as service improvement targets, cost-reduction, and capital investments should be phased in to allow private operators to fulfill their obligations within the prevailing political, legal and regulatory environment.

### Getting the process right

There is ample international evidence that PSP in the WSS sector can work well for consumers – rich and poor, governments and companies alike. But this success is dependent on getting the process right. This means:

- Creating strong political support and favorable public opinion by being competitive, consultative, and transparent throughout the process. This will ensure that long-term public-private partnerships can endure changes in political leadership, public perceptions and unforeseen changes in market conditions.
- Ensuring the credibility of the reform process through stakeholder consultations on service costs and performance targets, tariffs and tariff adjustments, and measures to improve management accountability and accounting systems. The public needs to be convinced that the reforms in general and PSP in particular will achieve better results more efficiently and cheaply than the prevailing service arrangements.
- Designing a clearly articulated reform program and regulatory framework within a credible time frame. There should also be a willingness to constructively use the feedback from consultations with all stakeholders to strengthen the reform program and transaction design.
- India has large numbers of poor people in its cities and towns and to ensure that they too benefit from the improvements that PSP can bring, it is very important to incorporate pro-poor measures at the design stage of the transaction. Representatives from



poor communities should be included in the consultation process and the transaction should include specific obligations to serve the poor, appropriate tariff structures and subsidy targeting.


- Pre-qualification of bids is an important part of the arrangements to ensure that only experienced and financially sound companies participate in the tender process. Designing well-structured tender documents with simple bid evaluation criteria and minimal post-bid negotiation will ensure the quality and transparency of the tender process and attract qualified private operators and investors.
- Appointing a reputable transactions adviser, with well-structured terms of reference, could enhance local capacity to manage the transaction, which in turn will attract appropriately qualified participants.
- Creating viable *regional utilities*, by pooling the assets and resources of small towns within a contiguous geographical area, would offer a commercially viable scale of operations. Such regional utilities have been successfully created in several countries, including the UK, France and Australia. This move would generate the critical mass of technical and financial resources to attract the operating expertise and capital investments normally limited to very large cities and towns.

### LESSONS FROM THE POWER SECTOR

- Structural and economic reforms, along with independent regulation, are pre-conditions for PSP. However, if services are to improve, some of these reforms must be introduced with or without a PSP initiative.
- Independent regulation is no substitute for comprehensive reforms.
- The political will for reform must be translated into enabling legislation, pre-PSP restructuring, appropriate tariff setting, acceptable labor strategy, and independent regulation.
- Any price increase must be accompanied by improved services for all.
- Utilities must treat people as ‘customers’ and not ‘consumers’.
- Continuous government support for an overall process of economic reforms, not just for a particular sector, is critical.
- Fixing supply but not distribution – as in the case of the Dabhol power generation experience – has a direct lesson for the water sector. The tendency to invest in newer sources of water without fixing the inefficient water distribution networks is akin to ‘filling a leaking bucket’.

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## Municipal Matters: Small Steps Towards Public-Private Partnerships

 At present, there are no Indian cities with private sector involvement in WSS service distribution but some cities are moving towards management contracts with private operators.

For example:

### Bangalore

The Bangalore Water Supply and Sewerage Board (BWSSB) is negotiating contracts for the operation and management of two pilot areas, each with a population of 1.2 million. The private operator will be responsible for water supply, sewage collection and treatment, revenue collection, and customer relations, including grievances, in these two areas.

The BWSSB will continue to be responsible for service delivery to the rest of the city, serving a population of 3.6 million. A regulatory unit will be set up within the BWSSB and if these initial concessions prove successful, two further concessions, covering the entire city, will be granted after five years. The contract is still being discussed after close to two years of negotiations.

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Bangalore Water Supply and Sewerage Board

### Mumbai

In 1990, the Brihan Mumbai Municipal Corporation created a separate budget for water and sanitation. The intention is to follow this by formal corporatization, and then the award of management contracts. In an attempt to improve efficiency and reduce losses, and in line with this

incremental approach, the Corporation is considering awarding a management contract, on a pilot basis, in a ward that has a population of over one million.

Bidding will be competitive and regulation will be by contract while payment to the private operator would include a fixed fee, plus incentives for reduction of unaccounted-for water. The Corporation would guarantee reimbursement of necessary rehabilitation works. An independent Dispute Resolution Board would resolve disputes. A date for completion of the process has not been determined.

*For more information, contact*  
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Brihan Mumbai Municipal Corporation

### Kolkata

A French company, Degremont, was awarded a contract to construct a water treatment plant in Kolkata. When this was completed, there were some difficulties in operating the plant, so the Kolkata Municipal Corporation (KMC) signed a fresh contract with Degremont. The private company will operate the plant for three years and during that time will build the capacity of KMC employees to enable them to run the treatment plant efficiently and take over all operational functions at the end of the contract period.

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Kolkata Municipal Corporation

### THE CITY CHALLENGE FUND: SUPPORTING THE TRANSITION TO CREDITWORTHY AND SUSTAINABLE CITIES

Responding to the urban challenge, and in the context of the 74th Constitutional Amendment, MoUD & PA has introduced a new fiscal instrument, the City Challenge Fund (CCF). Announced in the Budget speech of the Finance Minister for 2002-03, the CCF will be set up as an incentive-based grant to support cities to fund the transition cost of moving towards sustainable and creditworthy institutional systems of municipal governance, management and service delivery.

It is expected that the CCF grant will be provided on a competitive basis to cities as *budgetary support* for institutional change, not on a project basis, and will be payable in tranches against clearly defined performance benchmarks embodied in a well-defined restructuring plan. The Ministry has contracted a team to design the CCF in detail.

*Water distribution and sewerage services are key urban services eligible under the CCF as long as the criteria of institutional reform, including options for PSP, is the focus of the proposal.*



## The Heart of the Argument: Making PSP Work

To enable urban economies to flourish, and to ensure the well-being of all citizens, much needs to be done, and done quickly, to improve water and sanitation services to rich and poor alike. This workshop has provided diverse and encouraging case studies, illustrating how municipalities and other service providers can meet this most important of challenges. It has sent out some key messages, and also raised a number of important questions, providing the answers to which will form part of the reform process to which the Ministry of Urban Development and Poverty Alleviation is now committed.

- There is no single solution to suit all situations but global experience teaches us that a well-designed private sector partnership will increase coverage, improve quality, reduce water loss, boost revenues, and contribute significantly to the economic well-being of cities.

- It is also true that private sector participation must be embedded within the public sector, given the public-good nature of WSS services, and associated debt restructuring and fiscal implications. The Government will continue to set the policy and define the roles for private sector participation, which must form part of larger sector reform programs.

- It is vital for State governments and urban local bodies to set in motion a credible program of institutional reform to create the enabling environment necessary to attract experienced international companies willing to make a long-term commitment to improving India's WSS services.

- While the tendency is to invest in new sources of water, the real challenge is to improve the management of the distribution of existing water systems; improvements in the latter will lead to more rational decisions about the supply side.

- It is important to design contracts that benefit poor consumers. Some of the case studies presented here indicate that private operators are willing to innovate with new technology to increase connections in overcrowded areas that are currently unserved.

- A crucial element in the success of private sector participation is an appropriate legal framework, which establishes clear and transparent guidelines between private operators and State governments, municipalities or urban local bodies.

- Equally important for the smooth transition and operation of the private sector is competent regulation. Although for a federal country such as India, regulation at the State level would be most suitable (as practised in some States of Australia), WSS regulatory arrangements could be approached gradually, starting at the city level and moving to a broader State-level entity as more PSP arrangements emerge. This will help to build regulatory capacity and credibility; but it is important that regulation



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### VOICES...

"If the urban sector is to play its due role in generating faster economic growth and greater poverty reduction, the problems faced by India's cities and towns in meeting urban infrastructure demands, including water and sanitation services, must be addressed urgently."

**Kosal Ram, Secretary  
Ministry of Urban Development  
and Poverty Alleviation  
Government of India**

"India needs to provide clean water in a sustainable, cost-effective and efficient manner to all at all times. We can proceed ahead not by lip-service alone, but by working on details."

**S. Banerjee, Joint Secretary  
Ministry of Urban Development  
and Poverty Alleviation  
Government of India**

"Actions of regulators have a cause and effect relationship. Increasing political and regulatory risks will increase the cost of capital, leading to higher prices."

**Tony Ballance  
Former Chief Economist  
OFWAT  
UK**

"Public clamor for better service initiated the process of reforms and helped overcome all barriers."

**Mark Dumol  
Former Chief of Staff to the  
Secretary of the Department of  
Public Works and Highways  
Philippines**

alone should never be seen as a substitute for WSS sector reforms. However, even if adopting such a gradual path, the State should legislate the overall framework for the regulatory process upfront.

- While some cities are planning to involve the private sector for small pilot schemes, this is a slow process fraught with operational pitfalls. It is unlikely to attract the private capital required for expansion and rehabilitation of the WSS networks, and will have little impact on the massive challenge facing India. There is little doubt that adopting a citywide approach to PSP is necessary if the much needed sector reforms are to be achieved rapidly.

- For transparency, good governance, and ensuring that the public benefits from the strengths of the private sector, there can be no substitute to an

open and competitive process for engaging the private sector.

- Finally, to support States and their cities to undertake the important institutional reform of urban service delivery, particularly urban water and sanitation services, the Gol has introduced the City Challenge Fund. This will contribute to financing the transition costs of institutional reform.

**For more information, contact:**

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## Partnerships

This Think Tank was supported by the World Bank Institute (WBI), the Public-Private Infrastructure Advisory Facility (PPIAF) and the South Asian Infrastructure Department of the World Bank (SASEI). As part of support to the implementation of the World Bank's India Urban Water Sector Strategy, WBI and SASEI, in partnership with the Government of India, and with funding from PPIAF, have mounted a two-year learning and policy dialogue initiative. The initiative's main objectives will be to: 1) facilitate policy dialogue among decision-makers and stakeholders to bring about policy reform; 2) enhance public awareness and build support for reforms; and 3) increase capacity among those involved in projects for enhanced effectiveness and sustainability of reform efforts.



WSP-SA

## VOICES...

"Do not ignore the media. To succeed, communication is very important to garner support of various stakeholders."

**G.P. Rao, Chairman**  
**Andhra Pradesh Electricity**  
**Regulatory Commission**  
**India**

"Public-private partnerships are akin to a marriage. There has to be trust even in troubled times."

**Walter A. Stottmann, Manager**  
**Water and Sanitation Program**  
**The World Bank Group**  
**Washington, DC**  
**USA**

## The Urban Think Tank

The Urban Think Tank is a participatory forum that enables experts and practitioners to address issues related to the delivery of water supply and sanitation services to the poorest sectors of the community. The Think Tank is also intended to spark policy-level debate and provide a forum where the issues and concerns of municipal managers can be brought forward. Regular meetings have been hosted by the Water and Sanitation Program-South Asia (WSP-SA) in collaboration with the UK Department for International Development (DFID) since December 1994.

The 13th Urban Think Tank was held at Manesar on December 5-6, 2001. The purpose of the meeting was to generate discussion and debate on issues of private sector participation

in urban water and sanitation for managing the process and regulating the sector.

Through the publication of *Nagari*, the proceedings and key issues of each meeting are disseminated to municipalities all over India. The purpose of *Nagari* is to share lessons learnt, highlight emerging issues, illustrate examples of best practice and provide a link between municipalities and other stakeholders to foster a better operating environment in the water supply and sanitation sector. We would welcome your ideas on any of the issues discussed and feedback forms are enclosed for this purpose. Please also write to us with any comments and suggestions on topics that you feel are important for managers of local urban bodies.

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