

Annex: Summary reports from regional Consultations

2007 NEPAD-OECD Africa Investment Initiative Roundtable, Lusaka, November 2007

Session 1: The private provision of water and sanitation infrastructure services in Africa: where do we stand?

The OECD work presented in this session builds on the OECD *Principles for Private Sector Participation in Infrastructure* launched in 2007 to provide practical guidance to governments and institutions on how to make the most of private sector participation in water and sanitation. It is part of a broader OECD horizontal project on *Sustainable financing to ensure affordable access to water and sanitation* that addresses the economic basis for sustainable water service provision and sound water management.

The OECD water project relies on a review of specific country experiences of international and local private sector participation in the water and sanitation sector. It involves some 30 developing and emerging countries in Africa, Middle East, Asia and Latin America. The main information collected on African countries in terms of state of the resource, access level, performance of service delivery, institutional environment and trends in private sector participation were presented in a stocktaking paper.

The stocktaking exercise underlines the involvement of the private sector in the water and sanitation sector. Many countries have entered into contract with the international private sector in the last 15 years or are planning to in the coming years. Transactions are undertaken under a wide variety of contracts, but with a trend towards shorter, less risky arrangements involving less investment obligations. In parallel, new actors are emerging, such as local and regional actors, and there is a growing recognition of the small-scale private providers.

The challenges appear daunting, with very low access levels and limited operational performance of the sector leading to substantial investment needs. Limited access to drinking water and sanitation is a major human challenge as well as an impediment to business development. To help solve the internal problems of the water and sanitation sector, African countries have engaged in substantial institutional reforms.

Private sector involvement is one of the options that countries have at their disposal to improve the performance of the sector and increase population's access to water and sanitation services. However, countries need to have adequate tools to assess and manage

the implications of this involvement properly. The OECD *Principles for Private Sector Participation in Infrastructure* as applied to the water and sanitation sector provide such a tool by reviewing within a structured framework the specificities of the water and sanitation sector bearing on the co-operation between the public and the private sector; identifying the pertinent issues for governments; and presenting some country good practices and tools to overcome the difficulties.

Session 2: Applying the Principles to the water and sanitation sector

The discussion on private sector participation in the water and sanitation sector revolved around investment environment conditions and governance conducive to private sector involvement in a way that benefits all stakeholders. Four key points emerged from the debate:

1. Participants stressed that partnerships are multiple across the different stakeholders, including consumers, communities and NGOs. Hence, a **beneficial relationship between the stakeholders in the water and sanitation sector implies careful allocation and understanding of respective roles and responsibilities**. It also involves an understanding of the nature of the partnership and of the appropriate incentives to ensure that partners remain involved. This constitutes a precondition for sustainable co-operation.

Sound allocation of responsibilities requires the separation of the political role, from the role of administration and of operations of service delivery. Some countries have managed to achieve this separation through their contract; others have established regulatory agencies to help better define respective roles. The right allocation and understanding of the respective roles go beyond the setting of institutions.

Participants agreed that the OECD could help clarify the roles and constraints of the different stakeholders. On that matter, some participants stressed that the roles and responsibilities will probably not be found to differ much between private and public operators. Some grey areas will also probably be found (i.e. who communicates the good and bad news?). Respect of commitments remains the main follow-up responsibility of the different stakeholders. Government should support responsible business conduct: by supporting innovations coming from small-scale operators, for example. All tiers of government should also respect timely payments of bills. Institutions, such as AFUR (African Forum for Utility Regulators), that can help bring clarity to the role of specific stakeholders - the regulators in this case, based on benchmarking and peer reviews.

2. Participants underlined that relationships are not static. Partners face a constantly changing environment, which constitutes a major challenge in terms of their long-term contractual arrangements. **Their relationship is dynamic and should allow for the flexibility of adapting to these changing conditions**. In this type of environment, negotiations are necessary and healthy. The contract should facilitate conflict resolution.

3. All participants agreed that **promoting transparency is a critical element in the relationship between the partners and in tackling corruption**. Transparency involves information sharing that would help restore some symmetry in the relationships and greater consideration of population and community expectations. It also requires consistency and predictability of decision making.

Inclusive dialogue, as promoted by the Water Dialogue for instance, is instrumental to develop ownership and relieve conflicts, but takes time. The private sector must be called

upon to make their requirements and constraints clear to improve the design and relevance of contracts. Political leadership is a key element of success. Consumers' involvement has been successfully achieved in Zambia through the Water Watch Group.

Data collection and monitoring require more attention. In this regard, regional sharing of regulatory experiences and benchmarking is particularly useful in the water and sanitation sector.

4. Several participants reminded us that **financial sustainability, coupled with appropriate allocation of risks and costs across the stakeholders**, is a key element of success: in Senegal, a coherent financial model drives price setting. In that specific example, the extension of the network was born by all consumers and urban dwellers agreed to reduced hours of availability.

Session 3: Developing the uptake of financial risk mitigations: what role for donors?

Financing of infrastructure extension remains a key issue. There are notably big challenges in terms of serving the poor. However the participants shared an optimistic assessment. The opportunities exist and some promising avenues lie in Output Based Aid (OBA) schemes, blending financing sources (hybrid schemes bringing together public and private finance) and tapping into domestic sources of funding like social security funds (ex. the recently established Pan-African Infrastructure Fund). Some closing of the gap between small-scale and large scale lending is taking place, but assistance is still needed to overcome the challenge of preparing bankable projects to be able to access finance.

2008 ADB-OECD Expert Meeting, Manila, March 2008

On 5 March 2008, the Asian Development Bank and the OECD held a joint Expert Meeting on: *For a beneficial private sector participation in the water and sanitation sector, lessons learnt from Asian country experience*. The expert meeting aimed to advance the debate on private sector participation in the water and sanitation sector by providing a forum for participants to discuss and better define the key elements of a beneficial partnership. After the NEPAD/OECD Investment Initiative roundtable organised in Lusaka in November 2007, the ADB/OECD expert meeting was the second opportunity to discuss the draft OECD guidance on private sector participation in water and sanitation infrastructure, building on the experience of Asian countries. The meeting brought together high level participants and led to fruitful discussions.

The meeting was organised into 3 sessions:

1. Session 1 provided a broad overview by introducing the application of the OECD *Principles on Private Sector Participation in Infrastructure* to the water and sanitation sector and by sharing past experiences and trends within the sector.
2. Session 2 focused on two main areas highlighted by the OECD *Principles* as crucial for beneficial partnerships. Panel discussion A focused on the development of a conducive institutional and regulatory environment and Panel discussion B discussed the roles and responsibilities of various stakeholders.
3. Session 3 highlighted the access to financing as a major constraint to the development of the sector and to further involvement of the private sector. It aimed to draw attention to the financial innovations that could help lift the constraints on financing and facilitate private capital flows to the water and sanitation sector, based on the experience of the ADB.

The regulatory framework

A sound regulatory framework was highlighted as the key element for a successful partnership and in general for improved governance in the sector. Unpredictability of the regulatory framework and multiplicity of government agencies responsible for implementation and oversight are leading to dilution of responsibilities and unclear reference point for private actors. Remedies include regulatory reform and clearer and better defined allocation of roles across existing government bodies.

Some participants however stressed that regulatory bodies have often been overburdened with too many governance roles. There is a need to refocus regulatory functions around the key activities of: 1) tariff/price setting, 2) subsidies for the poor, 3) efficiency and performance incentives, 4) quality and environmental standards, and 5)

consumer protection. Quality and availability are important elements of regulation that should be jointly considered with tariffs setting. Regulation cannot substitute for appropriate design of contractual arrangements, which remain the basis for the relationship between the public and the private sectors.

Regarding tariffs, several participants highlighted the usefulness of regular rebasing exercises as components of long-term contracts. Given the long-term nature of private water and sanitation contracts, these would give the parties an opportunity to reassess the situation, take stock of present circumstances, and agree on a way forward. It raises the issue of the appropriate capacity on the part of the public partner to develop sound tariff strategies and to participate in the rebasing exercises.

Participants agreed that a good regulatory framework and a robust long-term water policy should apply to the overall sector, regardless of ownership of operators. Standards and requirements set by regulation should notably be the same for all and incentive-based rather than punitive. Some participants however underlined that the involvement of private actors has probably helped raise expectations and put pressure on private operators to provide higher level services than required by minimum standards.

Cambodia and China experiences illustrate how high level political commitment can contribute to driving reform. At the same time, participants agreed on the need to shelter the sector from undue political interferences. They underlined the importance of third party and professional technical advice to bring credibility to regulatory decisions, while stressing that the independence of third party should be strictly respected through appropriate financing.

Information and benchmarking

Participants insisted on benchmarking as a source of information to compare performance of water and sewerage providers, as a strong tool to drive efficiency and as an incentive towards greater transparency. Benchmarking involves developing a set of performance indicators that show how providers fare relative to each indicator i.e. coverage, non-revenue water, average tariff, collection efficiency. The ADB, through its Water Utility Data Books, has regularly conducted benchmarking exercises in the region. Consumer satisfaction surveys are also a good way to assess utility performance as shown in the Manila experience where academia has been a partner to both concessionaires and the government in the conduct of annual public assessment surveys.

Greater availability of information facilitates healthy competition among operators (including across public and private operators). Transparency on contractual arrangements is also necessary so the public will be aware of the goals and objectives in inviting the private sector in the provision of water and sanitation.

Roles and responsibilities

Participants posit that Governments should provide an environment that will allow for viable water and sanitation operators. It involves developing a clear regulatory framework, but also effective implementation of regulations and contractual provisions. In that context, clarifying roles and responsibilities is needed, including disentangling of functions, notably between oversight and service provision. Appropriate allocation of roles and responsibilities goes in tandem with clear identification of risks, rewards, rights and recourse across the various parties.

The service functions should be the responsibility of operators. Some participants pointed out the need to strengthen operators, be they public or private. This is precisely the objective of the WOP (Water Operators Partnership) program, a platform for mutual co-operation among water operators and utilities.

The experience of Manila Water shows that when the regulatory framework establishes effective incentives, the private companies can also contribute to improving substantially level of access and service. However, the participants highlighted the difficult trade-offs that reaching the poor involves. The private sector has to comply with contractual arrangements and is driven by ensuring an adequate return on capital. Where affordability is low, installing new connections may require establishing subsidies, with the risks of misallocation and that the less profitable customers are excluded – in that context, subsidising connections rather than consumption may help reach out to the poor more efficiently in areas where connection rates are low. Furthermore, if there is a clear necessity for private companies to be in line with the development goals set by the government, countries cannot afford to leave the connection and provision for the poor to purely corporate social responsibility actions. This raises the issue of the opportunity to set universal service obligation as a contractual arrangement and of its concrete application through investment programmes.

International financial institutions also have a role to play in assisting governments to package projects for private participation. However, after the Manila and Jakarta contracts packaged with the help of the IFC and with assistance from the World Bank for policy, regulatory and institutional reforms in the late 90's, there have been very few projects in the region involving private sector in water and sanitation.

Financing

Participants agreed that tariff setting was the cornerstone of a sound financing strategy as it determines future revenue streams and therefore both internal investment capacity and ability to contract a loan from financial institutions. The development of sound, bankable proposals remains a key parameter and an area where greater capacity building is needed. A closer collaboration between public and private actors in developing funding proposals could help bridge the capacity gap. But building demand also requires institutional reforms, cultural change and political will, all necessary elements to develop the capacity of utilities.

Serious challenges also persist on the supply side of financing. Some participants stressed the limited capacity on the part of financiers to assess risks and rewards. Participants also agreed on the limits of traditional instruments (on-lending by local governments for instance constrained by political considerations that may lead them to favour shorter-term expansive financing, but fully under their control) and the need to develop innovative forms of financing (involving credit enhancement, bonds linked to contracts). There is an active role to play for ADB in the area of risk mitigation instruments and in terms of financing for low income communities (such as setting up subsidy mechanisms targeting connection fees). New financial instruments launched by ADB include non-sovereign lending (allowing state-owned companies and local governments to borrow), local currency financing (dealing with the currency risk), and multi-tranche financing (allowing for single approvals for large scale projects with interest payments for

disbursed amounts only). However, financial viability of projects remains a major constraint.

The specific case of sanitation was highlighted. In that sector, tariff structures rarely reflect the cost of operating and maintaining the sewerage network and connection costs reach prohibitive levels. At the same time, the Bandung experience has shown the limitation of spreading the connection costs to all – even to the unserved – making it difficult to justify future additional charges for new connections. This urges regulators to look into tariff structures to provide operators incentives for sewerage connections and public authorities to consider subsidies that would target connection fees. Participants pointed out that innovative financing instruments and concessional funds will be necessary to make sanitation and sewerage services viable. More projects – public or private – are needed in the sector if the sanitation related MDG is to be reached.

Call for greater capacity building

Participants stressed the need for greater capacity building in the following specific areas:

- To develop understanding of the key elements of a public/private partnership and the roles and responsibilities of parties throughout the PSP process.
- To develop an informed involvement of civil society, communities and consumer associations.
- To support regulators and governments by professionalising technical capacities to avoid politicisation of tariff setting and adjustments.
- To facilitate access to funding.

IMTA-OECD Expert meeting, Mexico, September 2008

On 4-5 September 2008, the Mexican Institute of Water Technology and the Organisation for Economic Co-operation and Development held a joint Expert Meeting entitled “*For a beneficial private sector participation in the water and sanitation sector, lessons learnt from Latin American country experience*”. The expert meeting aimed to advance the debate on private sector participation in the water and sanitation sector by providing a forum to discuss and better define the key elements of beneficial partnerships. After the NEPAD/OECD Investment Initiative roundtable organised in Lusaka in November 2007 and the ADB/OECD expert meeting held in Manila in March 2008, the IMTA/OECD expert meeting was the third opportunity to discuss the draft OECD guidance on private sector participation in the water and sanitation sector, building on the experience of Latin American countries. The discussions focussed on recent experiences and trends in selected Latin American countries, the conducive institutional and regulatory framework, the respective roles and responsibilities of partners, their contributions in financing the sector and the conditions for improved transparency and accountability. Participants also provided specific comments on the OECD work. The report below summarises the key points made during the discussions.

Recent experiences and trends

Experiences with private participation in the water and sanitation sector have been very diverse in Latin America. Some have been considered to be successful, others not. It is difficult to make a global assessment of these experiences: diversity of local conditions – including financial, macroeconomic, and social –, the size of projects, the state of development of regulatory frameworks, the quality of the institutions, the technical capacity and independence of regulatory bodies etc ... all contribute to explain the outcomes of partnerships with the private sector. In addition, the interconnection of factors and the absence of sound baseline data complicate the identification of specific aspects of the various partnerships and the assessment of performance and outcomes.

The difficulties encountered by some concession contracts with large multinational companies – that led in some cases to cancellations - were due to a range of problems, such as incomplete initial sustainability assessments (including ill-defined objectives and deficient risk assessment), badly designed tender processes and contractual arrangements in a context of adverse macroeconomic conditions and inadequate regulatory frameworks. These difficulties have had and continue to have important repercussions, including ongoing disputes under international arbitration and a redefinition of the modalities of private participation in the sector.

The positive experience of Chile was however highlighted. Participants also mentioned the potential of partnerships with community members, including the cooperation between the users and the municipality in Puerto Cortes (Honduras), the Saltillo mixed concession (Mexico) and the development of urban cooperatives in several countries of the region. Participants also discussed the importance of exploring innovative solutions that build on local initiative and capacity, including the potential merits of franchising, i.e. local businesses using proven management processes and operational standards developed by more experienced companies.

Some participants however pointed out the risks that the new developments of decentralised systems may involve: on the one hand, smaller, decentralised systems may favour greater community involvement and complement traditional forms of provision where coverage is still insufficient; on the other hand, they may lead to significant losses in economies of scale, challenge regulation and control (of water quality for instance), impede the application of cross-subsidies and, in some instances, generate greater risks of corruption.

Private participation in the water and sanitation sector has also triggered important shifts in the focus of public policies, by drawing stronger attention to efficiency of service provision, quality of service, sector organisation, regulation and the need for greater community involvement in planning and definition of objectives.

Finally, participants were of the view that governments should conduct a thorough assessment of the activities that would benefit from private sector participation (considering that public sector provision can also be efficient), clarify objectives for both the public and private sectors, allocate adequately the risks across partners and ensure continuous monitoring and assessment of results. In addition, the chosen model of private participation needs to be coherent with the economic and social context of the country and based on political and social consensus.

Institutional and regulatory framework

In most Latin American countries, the water and sanitation regulatory framework is poor. It is often complex and imported from abroad without adaptation to local needs. It also often lacks a technical basis and does not clearly specify the incentive and sanction mechanisms. Participants highlighted that the lack of an adequate regulatory framework has had significant negative consequences, such as poor performance of service providers (be they public or private).

Participants also highlighted the benefits of a regulation based on law, compared to regulation by contract, in particular when the private sector is involved. Regulation based on law has the advantages of greater public exposure, diffusion and transparency (notably through parliamentary debates). By contrast, contracts may be confined to a smaller group of informed people.

It was widely acknowledged by participants that a sound institutional framework contributes to improving certainty, limiting arbitrary decisions and increasing credibility of the system, and ultimately leads to more efficient service provision. Establishing a high quality regulatory framework requires political will and great technical skills – involving engineers, lawyers and economists. This necessitates time and progressive improvements.

Developing the appropriate institutions also requires establishing a good information system that notably corrects the information asymmetries between the provider and the regulator. Lack of information hampers efficient regulation and prevents policy makers and regulators from setting appropriate and reachable goals for the sector, in turn undermining population's trust in public administration.

Some participants raised the issue of pragmatism: what to do in the short-term with incomplete regulatory frameworks and the subsequent spreading of auto-regulation? Another issue was whether the regulatory framework should be the same for all or differentiated between public and private actors. In general, participants were in favour of a single regulator, regardless of the ownership of the operator. Other participants highlighted the need to align regulation in the water sector with other government priorities, such as resource conservation and health objectives.

Roles and responsibilities

Participants identified governments' excessive handing-over of their responsibilities as a major cause of failure in public-private partnerships. Government should remain the enabler and is, *de facto*, responsible for the bulk of investment in the sector. This involves establishing a high quality institutional and regulatory framework and a commitment that all, including the poor, be provided with adequate water and sanitation services. Some participants also highlighted the role that governments can have in promoting the development of innovative forms of service provision.

There is no ideal allocation of roles across levels of government. It depends, among others, on local conditions, capacities and inherited structures. Separation of roles – between service provision, supervision, regulation and policy making – remains however crucial, as does the existence of co-ordination mechanisms and effective communication channels. Participants expressed the view that capacity building at different levels of government is very important, but that in many countries this has not been put into practice.

The discussion also addressed the specific roles that regulators should play – which include controlling service quality, price setting and review, ensuring the long-term sustainability of water provision and sanitation systems, supervising the operators and communicating with the various stakeholders. Some participants highlighted that while formal channels of communication between the regulator and the operators exist; communicating with users and developing users' awareness of sustainable water use and conservation remain great challenges in the region. Consumers' participation in the regulatory process also remains largely ignored. Some participants considered that, in certain circumstances, the private sector can play an important role in ensuring service coverage to the poor, mentioning the potential of co-operation between the "formal" operator and the local communities in poorly served peri-urban settlements, along the lines developed by microcredit schemes. In this specific case, the operator is in charge of the upstream segment of water provision, i.e. of bringing water to the borders of the peri-urban settlement, while local communities take care of internal distribution of water and of wastewater management. Some participants however questioned the idea that ensuring access for all is the private sector's duty. Others mentioned risks of "cherry picking" practices.

Participants agreed that population buy-in was an important element of the success of policies and initiatives in the water sector. For example, community participation in the planning phase has proved to contribute to generating confidence and greater ownership.

Financing

The water sector is often considered risky for private investment, notably because of its vulnerability to external economic and socio-political shocks, inadequate regulation, lack of institutional continuity and insufficient availability of baseline data. Often, however, the key problem is not lack of financial resources (local financing is considered available), but access to it, at competitive levels. Reasons for this include lack of political will – water is rarely among governments’ top priorities. The effective and efficient use of funding is also an issue, particularly at local levels of government where lack of capacity may hinder the implementation of investment plans.

Participants considered that adequate pricing is a strong driver for investment. A stable revenue stream is necessary to allow and reward investment, but also to support the creditworthiness of operators and ultimately ensure an efficient and sustainable provision of water services. Some participants highlighted the fact that in Latin American countries, banks do not accept the revenue of water operators as collateral for loans and often request State guarantees to ensure creditworthiness.

Low water prices are an illusion for the users, since they generally correspond to low quality of the service and the supplied water, with the subsequent health hazards and the need to purchase bottled drinking water. In some countries, the willingness to pay for water provision and sanitation services is low. Moreover, in some countries, for example, Mexico, large sections of the public sector are exempted by law to pay. In such contexts, increasing prices will not necessarily materialise into improved services, as users may simply refuse to pay their bills. Efforts are therefore needed to change the “water culture”. Pricing policies should also be combined with concrete improvements in access conditions, service quality and bill-collection and public support, which may facilitate public acceptance of higher prices.

Some participants emphasized the importance of public financing for sewerage and to ensure that all, including the poorest sections of population, have access to water services. In particular, participants highlighted that it is important to implement focused subsidy mechanisms targeting low income and vulnerable populations, as is the case in Chile. These mechanisms should be based on precise population targeting methodologies. Some also made calls to be realistic and match the available and affordable technology with the need to extend water services to all, and to focus more on effective coverage (which also includes water quality and the safe disposal of used water). The risk associated with this approach is to generate a perception of discrimination.

Accountability

Participants were of the view that whatever the model of service provision – private, public, mixed, community-based –, there is a need to strengthen efficiency, accountability and transparency. As of today, the public sector generally remains poorly accountable in terms of performance of service provision, and the general framework for transparency and accountability is often inadequate and hardly geared towards the interest of users.

In particular, current instruments to support disclosure of and access to information on water services (and to prevent its capture by specific interests) are weak. One important challenge is to introduce regulatory accountability and improve the control of purchases and contracts with related companies in order to develop better knowledge of the real costs and facilitate the analysis and supervision of the efficiency of operators.

There is little knowledge among government officials of how best to use the available information. Some efforts are however being made to improve access to relevant information. In some countries, for instance, the consumers are involved in cross-checking the information coming from water operators (public and private). In others, internet is used to publish key information and offer users a platform for discussion.

Participants considered corruption to be a great concern in the water sector. Some participants emphasized that in some countries corruption is prevalent throughout society and strongly impacts on the delivery of services. It was suggested that an important step to prevent corruption is to professionalize the water sector. Other suggestions included independent regulation, better access to information, professionalization of the public administration structure, greater control of electoral funding, and greater supervision, notably of decentralised systems. Participants were also of the view that there is not a one-size-fits-all solution to the problems linked to corruption, but that efficient solutions will depend on multiple factors, such as political will, culture, and institutional framework.

OECD draft Checklist for Public Action

Participants provided their views and suggestions on the OECD *Checklist for Public Action*. In general, they considered that it can be a useful tool, to the extent that it builds on lessons learnt from recent experiences with private sector participation in the water sector, especially the identification of the causes for success and failure. Among the suggestions for improvement were: to better prioritise the key issues for consideration by governments; to make the format of the *Checklist* more practical; to better address the potential effects of dispute settlement mechanisms; to clarify the issues raised by the diversity of private actors; to reassert that government priorities should be an efficient provision of services to all and the related conducive framework; and to introduce more elements on innovation.

Advisors and Special Experts

This work benefited from the inputs of the experts involved in the regional roundtables.

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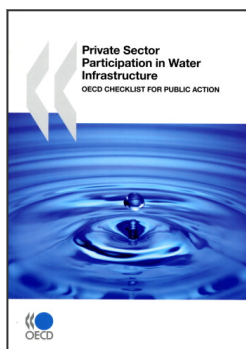
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