

PANEL OF FINANCE AND DEVELOPMENT COOPERATION MINISTERS AND EXPERTS

Conference Room 1, UN Headquarters, New York, 18 April 2005, 4:30 p.m.

International Policy Dialogue on Water Provision for Human Consumption in Developing Countries

Issues Note by the UNCTAD secretariat on International Trade, Investment and Development Aspects of Policies Relating to the Provision of Water and Sanitation Services at the National and International Levels¹

Provision of water and sanitation

1. Water is essential for human survival and well-being, and it is also an essential commodity for economic activity, like energy. The provision of water is a sensitive matter in the development process, so much so that it is regarded as a strategic and security issue. Moreover, water is a “merit good”, a good to which, independently of other considerations, the State should provide universal access.
2. Access to safe drinking water and basic sanitation is one of the three targets of Goal 7 of the MDGs on ensuring environmental sustainability, with a commitment to reduce by half the proportion of people without sustainable access to safe drinking water by 2015. Access is a question of physical accessibility by consumers in urban and rural areas and of the affordability of such services. Worldwide, an estimated 2.4 billion people lack access to basic sanitation and 1.2 billion, or one in five, lack safe drinking water. Meeting the growing demand for water in developing countries in a sustainable way is therefore a key challenge.
3. In the 1990s, sector practitioners and policymakers reassessed the traditional supply-driven water supply and sanitation programmes in developing countries, which were often part of large-scale donor infrastructure programmes implemented through central governments or independent NGO interventions. They acknowledged the merits of a demand-driven approach in guaranteeing the sustainability of water and sanitation services² in accordance with what have been called the Dublin principles. These provide that (i) water should increasingly be considered as both a social and an economic good; (ii) water has to be managed at a level as close as possible to the grassroots; (iii) the use of water resources has to be considered in a global approach; and (iv) women have to play a key role in the management of water.
4. The demand approach suggests that users determine the quantity and the level of services and decide on projects, technologies and the quality of service, giving consideration to issues such as capacity and willingness to pay, the management of

¹ The purpose of this note is to summarize in a preliminary and non-exhaustive fashion some issues highlighted in policy dialogues, notably in the context of international trade negotiations.

² J. Sara et al. Important Messages of the Demand -Driven Approach. Community Water and Sanitation Conference May 5-8, 1998.

funds, and operation and maintenance modalities and project cycles. The Government defines national policies and strategies, plays the role of a catalyst and encourages learning. An enabling environment increases the participation of a variety of actors, and communities are adequately informed to enable them to make collective decisions and deal with partners.

5. Due to a number of different constraints, in particular lack of financial resources, many developing countries have not been able to catch up with the growing domestic demand for water and sanitation services. The World Summit on Sustainable Development Working Group on Water estimated that global investment in the water sector will need to increase from US\$ 70–80 billion annually to some US\$ 180 billion if the 2015 target on water is to be reached. In facing this challenge, a fundamental question has been raised: How can state inability to provide these essential services be offset? One option, actively promoted by the international financial institutions and some donor countries, is increasing reliance on markets, by means of privatization, deregulation and the removal of non-targeted subsidies, for the provision of water for human consumption and sanitation services.³ At the Third World Water Forum, in Kyoto in March 2003, the Camdessus Report helped institutionalize the use of bilateral aid and World Bank resources to boost the privatization campaign, and this policy option has been consistently implemented by the international financial institutions, thereby limiting resources available for public development of water and sanitation services.
6. Some developing countries, following the advice of the international financial institutions and in some cases as a result of conditionality attached to different programmes, adopted the market-oriented option for the provision of water and sanitation services. The results of these experiences are mixed. While in some cases private participation has contributed to increasing their availability and quality, other cases have proved complete failures, leading even to the termination of the contracts with foreign firms.⁴
7. In general terms, research on the water sector suggests that the private sector might not be more efficient or effective than the public sector.⁵ Also, there is evidence that

³ The OECD Secretariat has published two documents highlighting the win-win outcome of privatization of water for human consumption.

⁴ The cases of Cochabamba in Bolivia and Manila in Philippines, among others, are illustrative of failures. Similarly, the results of the privatization of water in Argentina are mixed, with costs increasing and water not reaching the numbers of users agreed in the initial contract; see UNCTAD. FDI and development: the case of privatization-related services FDI: Trends, impact and policy issues. Note by the UNCTAD secretariat. Expert Meeting on FDI and Development. Geneva, 29–31 October 2003. TD/B/COM.2/EM.14/2. 12 September 2003, p. 11.

⁵ Estache A and Rossi M (2002). How different is the efficiency of public and private water companies in Asia? World Bank Economic Review Vol 16, No 1. Oxford University Press, Oxford June 2002. Refer also to: Clarke, G, Kosec K, and Wallsten, S (2004). Has private participation in water and sewerage improved coverage? Empirical evidence from Latin America. World Bank Policy Research working paper, No 3445.03/11/04. Also see Tim Kessler and Nancy Alexander, Assessing the Risks in the Private Provision of Essential Services. Group G-24 Discussion Paper Series. No. 31, October 2004. United Nations. Also see UNCTAD. FDI and development: the case of privatization-related services FDI: Trends, impact and policy issues. Note by the UNCTAD secretariat. Expert Meeting on FDI and Development. Geneva, 29–31 October 2003. TD/B/COM.2/EM.14/2. 12 September 2003

privatization tends to contribute little to extending networks and providing affordable services, in particular to the poor segments of the population and disadvantaged regions. Furthermore, the reaction of the private sector to reform has fallen short of what was expected. Private resources are not readily available for investment in developing countries, in particular the poorest ones. Even if privatized, the sector depends on significant flows of resources from the donor community and in many cases from the host country that undertakes the bulk of the required investments or underwrites the risk and provides subsidies to private companies to provide water and sanitation services to non-profitable regions or poor communities.

8. In developed and developing countries alike, purification and distribution of drinking water and sanitation services are activities in the government domain, albeit with varying degrees of involvement by central, state and local levels of government in different countries. The private sector currently provides water services to about 5 per cent of the world's population, and only a few countries, inter alia the U.K and Chile, have fully privatized water services. Public-private partnerships, especially concessions, are preferred to full privatization. Given the magnitude of state commitment on water and sanitation services and the particular nature of those services, the public sector will remain central to the development and use of water resources for human consumption and provision of sanitation services in the foreseeable future. Accordingly, the public sector option must be taken into account as a potentially viable means for addressing some of the more pressing needs of developing countries and contributing to the achievement of the MDGs. There are a significant number of cases of reformed public utility services in developing countries that have been able to meet the growing demand for drinking water and sanitation services while improving their quality.⁶ Success stories in developing countries are not confined only to big cities, but are also found in small towns and rural communities.
9. There is a substantial body of evidence on problems and success stories with both public-private partnerships (PPPs) and public water undertakings (PWUs). It would be very useful to come up with an analysis and methodology to evaluate PPP proposals as compared to public sector options. It would also be important to evaluate the past experience of developing countries with international private water operators and to analyse, for example, key players and their strategies; difficulties faced by these groups to find "winning formulae"; the experiences in specific social and economic conditions in developing cities/metropolises and rural areas; and other issues.
10. Large private operators currently have a very small market share in developing countries. Small-scale independent water providers, operating small pipe networks, kiosks and water trucks, play a major role in developing countries, where in many cities half of the population or more is served by water suppliers other than the utility. Until now the debate has focused on large-scale operators and ignored small-scale operators. It is important to broaden the debate to address issues specific to decentralized water systems, particularly ways and means of promoting partnerships

⁶ Among other cases the following are worth noting: Porto Alegre and Sao Paulo in Brazil, the City of Bogotá, Sri Lanka, Botswana, Bangladesh, and the State of Penang.

involving local engineering companies and engineering companies from developed countries.

11. It should be noted that the interest of international water companies in developing countries, in particular the poorest, is diminishing because of high risks and the difficulties involved in making a profit in a highly regulated environment. Even in developed countries, water companies are exiting the market due to low profitability rates. In the U.K., water companies have sold their interests to financial entities, private equity companies and banks, which appear more interested in the cash flow than in the actual rate of return.⁷ Thus, the viability of the market approach for providing these essential services for many developing countries, in particular small markets and LDCs, should be carefully assessed.
12. To summarize, in adopting a market-based approach, developing countries face a number of significant challenges. One is how to reconcile a "rights-based approach" to the provision of drinking water with private involvement and market mechanisms. A crucial issue is therefore the type of state intervention that would be required to guarantee universally accessible and affordable services under the free functioning of markets. Regulation of private undertakings in this area is essential. However, there is always the risk of regulatory failure, or regulatory capture, in particular in countries lacking institutional and enforcement capabilities. The welfare costs associated with this failure could be enormous. As water provision tends to constitute a natural monopoly, at least at the regional level, the relevant question is: what can developing countries control more easily: a state monopoly or a private one? There is also the issue of control of water resources. How could the purification and distribution of water resources be handled by private firms without them being given some rights to access to the main resource?

International trade in water and sanitation services (WSS)

13. International trade in water and sanitation services⁸ and equipment will play an increasingly important role in efforts to ensure that the availability of these services keeps pace with population growth and economic development. Trade in water and sanitation services (WSS) - through , *inter alia* , management contracts, BOT schemes and concessions - may contribute significantly to (i) increasing the level of coverage of WSS, (ii) upgrading the quality of local services, and (iii) bringing down WSS costs to users through efficiency gains.⁹
14. At the Fourth WTO Ministerial Conference in Doha in November 2001, WTO Members agreed to negotiations on *'the reduction or, as appropriate, elimination of tariff and non-tariff barriers to environmental goods and services'*¹⁰. The liberalization of trade in basic environmental infrastructure services - such as water

⁷ New York Times, 09-04-2003.

⁸ Trade in water and sanitation services takes place through what in WTO/GATS terminology is termed "commercial presence", i.e. foreign direct investment.

⁹ For a detailed discussion, see for example Simonetta Zarilli, In: International trade in environmental services and the developing countries. Energy and environmental services. Negotiating Objectives and Development Priorities UNCTAD. Geneva. United Nations . New York and Geneva, 2003. UNCTAD/DITC/TNCD/2003/3. pp.287 ff.

¹⁰ Doha Ministerial Declaration, paragraph 31 (iii).

and sanitation - may lead to increased participation of foreign and domestic private actors in sectors of vital importance to the economy and society. Of particular concern is the emergence of "public service TNCs" in the water sector, which is, in part, influenced by the other public utilities, especially electricity.

15. Some developed countries are reportedly requesting other WTO Members, even LDCs, in the current round of negotiations under GATS Article XIX in the context of the Doha Work Program, to adopt binding specific commitments liberalizing water services for human consumption and other environmental services, including sanitation. In making such requests, the concerned developed countries highlight the fact that they are not seeking either to dismantle public services or to privatize state-owned companies. Such requests exclude access to resources (i.e. ownership of the water itself) and any cross-border transportation by pipeline or other means. It should be noted, however, that discussions on the definition and classification of water-related services as services subject to GATS provisions and negotiations are still ongoing.¹¹ Developing countries have agreed that domestic reform bound in internationally enforceable commitments is deemed sufficient to address the needs of developing countries with respect to water and sanitation services, mobilizing resources unavailable to cash-strapped governments, and ensuring delivery of high quality services.¹²
16. While WTO Members have flexibility to protect basic environmental services in the GATS positive list formula, in reality developing countries may be driven into fast liberalization in the context of the single undertaking in the WTO negotiations or in the context of regional or bilateral trade liberalization agreements. It has also been noted that other institutions, such as international funding agencies, have made liberalization a precondition for future lending to allow for private investment flows in environmental infrastructure. Developing countries are best advised to properly sequence their privatization and establish a proper regulatory framework to ensure an appropriate balance between availability and profitability in the sector, while requiring universal access to water.
17. There are other problems that extend beyond trade negotiations. Liberalization efforts in the WTO should be considered in connection with possibilities to finance public efforts. No institutional linkages have been established between the negotiations and all the different fora that deal with development finance and assistance.
18. Finally, there are constraints on the supply side to which the WTO is ill equipped to respond. These and other related issues came into focus at the Expert Meeting on Definitions and Dimensions of Environmental Goods and Services in Trade and Development, organized by UNCTAD in July 2003. The conclusions and recommendations of the Expert Meeting testify to the fact that water management is

¹¹ Some argue that water distribution cannot be considered as an environmental service. Others argue that water distribution cannot be considered a service at all, but rather (the production of) a good. Yet others consider potable water to be an exhaustible natural resource. Economic, political and social considerations underlie this seemingly technical debate, as the inclusion of water collection, purification and distribution services may raise questions about market access versus access to and control over water resources.

¹² During his confirmation hearing at the European Parliament in October 2004, the EU Commissioner for Development and Humanitarian Aid, Louis Michel, pointed out that public services are key to meeting basic needs in developing countries and that essential services should be exempt from market pressures.

essentially a development issue rather than a trade issue and should be seen in a broader context of sustainable development.

Issue s for consideration

19. A key question for consideration by the Commission on Sustainable Development is how to mobilize the international support, the financial and technical assistance, and the know-how and innovation skills needed to build capacity in developing countries to meet the ever-growing water needs of their populations in the broader context of their sustainable development needs. At the national level, while private sector intervention could contribute to upgrading WSS, the capacity for the public sector to coordinate WSS and other development strategies on the one hand and to provide social, economic and environmental safeguards and public goods on the other remains crucial.
20. Government action is required inter alia to (i) ensure equity of water supply and affordability among differently endowed regions and population groups; (ii) protect water resources; (iii) address public health concerns, including emergencies; and (iv) address high sunk costs related to geophysical characteristics.
21. At the international level, policies and measures that promote international financial assistance from bilateral and multilateral donors are required to mobilize concessional financial support for WSS, in particular public water utilities, in accordance with the recommendations of the recently released Report of the UN Millennium Project.¹³ Furthermore, as suggested by many NGOs active in this field, public water utilities in developed countries should be encouraged to assist in meeting the water MDG through not-for-profit public-public partnerships. International financial institutions should re-orient their policies to put less emphasis on privatization conditions and pay more attention to providing concessional financial support to public water- and sanitation-related infrastructure.

¹³ UN Millennium Project. Investing in Development. A Practical Plan to Achieve the Millennium Development Goals. New York 2005