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**Economics and governance of
essential or basic services**

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Links to the World Bank's *Infrastructure Action Plan*

Essential services are both:

1. Weapons in the **war on poverty**;
 - ◆ An essential dimension of human dignity, through the right of access to these services (social and local cohesion, solidarity)
2. Major contributors to **sustainable development**;
 - ◆ The proper functioning of essential services impacts on private investment and economic development (concept of endogenous growth) by way of externalities.

3. A **distinction** can be made between:

- ◆ **Utilities** (water, sanitation, waste removal, energy, transportation, etc.),
- ◆ **Commodities** (electricity, gas, telecommunications, etc.),
- ◆ **Facilities** (for economic operators only),

according to the level of individual needs and the user's ability to bear all or part of the cost of a service (including infrastructure costs).

Millenium Development Goals (MDG)

After five years of rather mixed results, certain questions arise:

1. Why only seek to meet the needs of half of the population deprived of access, while not specifying the level of service that is possible or desirable?
2. It took 100 to 150 years, and substantial government funding, for water and sanitation to become universally available services in developed countries.

3. Should we not set **medium-term goals, differentiated** by geographic area and context?

These could be **achieved in stages**, but should **deliver rapid initial results**, to be followed by more ambitious projects.

Therefore, it would seem necessary to:

1. Define the **steps** that would make it possible to reach a guaranteed level of service for all;
2. Secure a **substantial share of government funding** to finance the **infrastructure** for essential services;

3. Give **due priority** to the operation of services, the sole guarantee of **sustainability**.

Moreover, there appears to be an increasingly obvious need for **global, horizontal approaches covering all essential services** as well as **urban development**.

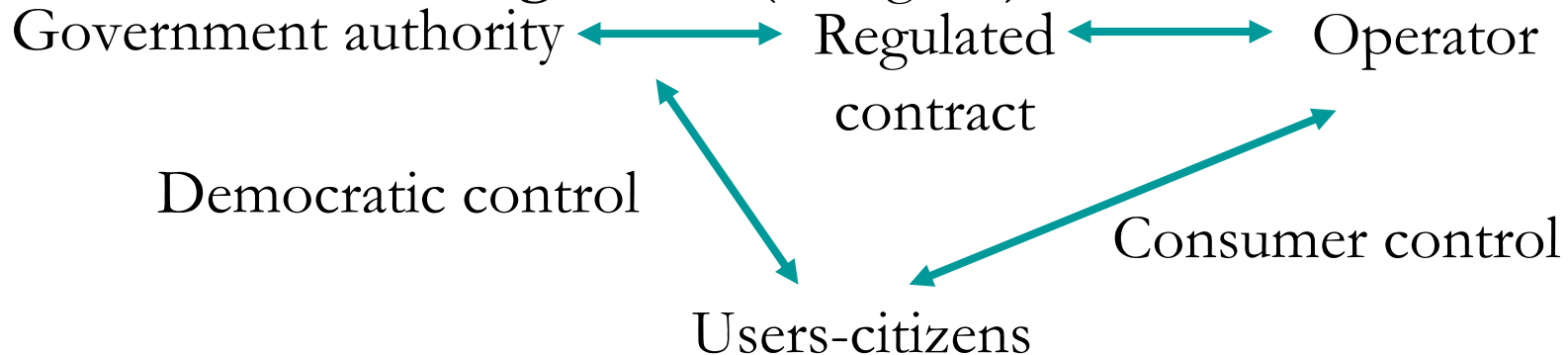
Three major models of regulation and governance

1. Regulation through a regulatory commission

Regulator ↔ Operator ↔ Consumer

A face-to-face relationship in which the operator may have the upper hand over the regulator (unequal access to information)

2. Contractual regulation (triangular)



- ◆ Government authorities supervise/Professional management (private or public sector)
- ◆ A role for user-citizens who participate in the government authorities' supervision of the operator
- ◆ A form of self-regulation that is more at arm's-length and alleviates the risk of capture by the operator

3. Regulation on a hierarchical basis

- ◆ A public-sector operator under the supervision of a government authority
- ◆ Risk of confusion or reversal of roles, as management and labor unions seek to replace government authorities in setting the goals of the service.

Clarification of responsibilities under a contractual model

1. The government authority:

- ◆ Defines the expected outcomes of the service, in coordination with users and stakeholders;
- ◆ Specifies the **level of service** to be achieved, defining it through **performance indicators** to be met;
- ◆ Determines the performance **incentives** (price caps rather than cost plus);
- ◆ Sets the **tariff policy** and mechanisms for promoting **solidarity**;
- ◆ Specifies the **methods for monitoring** and periodic **review** of the contract.

2. **Operator** (public or private):

- ◆ **Operates the service and/or infrastructure** in accordance with the goals set by the government authority;
- ◆ **Proposes** improvements in performance;
- ◆ Undertakes **capital expenditures** for **replacement and further development**, as set down in the contract or determined by the government authority.

Various methods of managing services

1. Public-sector management

- ◆ Direct government management
- ◆ Management by an **autonomous** public-sector agency (public body) with goals set by contract

2. Private-sector management

- ◆ Operator under **contract**, selected for a **fixed period of time** through a competitive bidding process (delegated management, PPP)

- ◆ Operator awarded a **license** (or franchise) to operate the service, normally chosen through competitive bidding;
 - ◆ Operator selected for an indefinite period, following **privatization** (auction procedure).
- 3. Management by a non-governmental organization (NGO), a community association, etc.**
- ◆ This solution may be appropriate for rural communities or specific urban neighborhoods, as a supplement to or replacement for public- or private-sector management

Difficulties in comparing public- and private-sector management

1. Numerous **differences** (distortions)
 - ◆ Taxation
 - ◆ Payroll taxes
 - ◆ Accounting rules
 - ◆ Are all expenditures reflected in the income statement?
 - ◆ Is depreciation taken into account (sustainability) ?
 - ◆ Is there a balance sheet (assets) ?
 - ◆ Are off-balance sheet risks adequately covered (profits, insurance)?

2. There may be ideological prejudices, depending on the country or the time period.

Two approaches:

- ◆ A rational, economic approach that allows differences to be taken into account
- ◆ An ideological or political approach.

3. Need for **harmonization**, so that choices may be based on objective criteria, without prejudice and with full knowledge of the facts.

General principles (charters)

1. **Clarify the roles** of stakeholders: government authorities, operators, users, others;
2. **Specify** by the government authority the service's **public interest outcomes**, the **goals** to be met, the **level of service** to be achieved and the **tariff policy principles**;
3. Allow a **free choice** of the management system, and make it **reversible**;
4. Promote **rational choices** among different management methods based on **benchmarking**;

5. Organize **competition** among operators and make choices with discernment.
6. Favor **contractual** solutions that include **incentives** linked to goals to be met, in conjunction with measurable **performance indicators**;
7. In order to improve government policies, provide for regular **multi-participant evaluations**, promoting **democratic discussion**;
8. Develop **win-win situations**, based on long-term **trust** and **cooperation**

Performance indicators

1. There is a **dual purpose** in determining these indicators:
 - ◆ Facilitate **dialogue** and **supervision** of the operator's management by the government authority, whatever his legal status;
 - ◆ Facilitate **open discussion** among government authorities, the operator and users-citizens.

In short, indicators should be established through discussion and agreement among all stakeholders.

Performance indicators:

Example of urban transport

The efficiency of the entire urban transport system depends on three inseparable elements:

- ◆ The **relevance of government policy** (capital expenditures, segregated bus lanes, parking, traffic plans, tariff policy, etc.);
- ◆ **Operators' overall performance** (quality of service, productivity);

- ◆ **Essentially civic-minded behavior of users/citizens** towards the transportation system (choice of means of transportation, fraud, etc.)

Taking into account these interactions, and society's interest in mobility (access to jobs and services, social cohesion, etc.), there is a need for a **series of indicators, used and developed jointly** by the different players involved.

Performance indicators:

Example of urban transport (2)

1. Work under way - 2 steps:

- ◆ A functional analysis, the first step in a public transportation policy,
- ◆ Elaboration of about ten indicators (easy to implement, understandable by all).

2. Dimensions of the performance of public transport services:

- ◆ Accessibility (by geographic areas and individuals in the transportation network)

Indicators of the availability of public transport under discussion, including: the portion of the population served; the portion of the population living less than xxx meters from a bus or tramway stop or a railroad or subway station. The number of destinations possible, the time needed to access a regional town, the closest urban center or the closest public service(s) should be taken into account.

- ◆ Attractiveness
- ◆ Economics of the system (price/quality ratio)
 - Indicators under discussion: distribution of costs among participants or resources – employers, taxpayers, users; elements related to expenses by the different participants in each mode of transport (local transportation accounts); comparative return on investment in public transport or roads.
- ◆ User information and participation
- ◆ Sustainability of transport infrastructure and operating assets

Performance indicators: Example of water and drainage (1)

- ◆ Overall approach: indicators aiming at measuring the performance of the various components of a service: including technical, environmental, and financial aspects, the condition of fixed assets and user satisfaction.
- ◆ List of performance indicators drawn up by IGD and adopted in France (see table).

Performance indicators: Example of water and sanitation (2)

Service concerned	Criterion	Indicator
Water	Continuity (quantity and quality)	Rate of interruptions not programmed
		Rate of conformity of bacteriologic analysis (DDASS)
		<i>Rate of conformity of physico-chemical analysis (DDASS)</i>
	State of fixed assets	Linear index of losses and consumed water, not counted
	Management of the resource	<i>Progress index on protection of the resource</i>
Drainage	Continuity of collection	Rate of overflow on users' premises
		<i>Rate of obstructions in the network</i>
	Cleaning up and treatment	Rate of conformity of sludge removed
	State of fixed assets	Rate of black spots per kilometer
	Management of sludge	Rate of sludge evacuated through permanent systems
Common (with distinct value for each service)	User satisfaction	Rate of complaints
	Price	Price per m ³ for 120 m ³ VAT included (yearly invoice in three sub-parts)
		<i>Average price (receipts / volume)</i>
	Recovery	Rate of unpaid water invoices (n-1) as at Dec. 31 of year n
	Long-term management of fixed assets	Fixed asset policies (network)
		<i>Length of the extinguishment of the local government debt (carried only on M49n)</i>
<i>Net savings of the local government per square meter (carried only on M49n)</i>		

Rate policies

1. Free service? A bad idea?

- ◆ Water is a “gift of God,” but God forgot to put it in water mains and make the service work.
- ◆ The poor generally pay more for less service (water carriers, taps managed by private interests); in fact, the poor can contribute to the cost of water in accordance with their ability to pay.
- ◆ Because funding is insufficient, free service generates waste and a deterioration of fixed assets due to lack of maintenance.

- ◆ It is possible to provide a limited quantity of water free of charge to the poor or to target subsidies for connection to water mains or reduction of rates (e.g. Global Partnership on Output-based Aid)
- 2. Determine how **costs are to be shared between users and taxpayers** based on the characteristics of the related infrastructures (depreciation period) and ability to pay (level and uses of disposable income).
- 3. **Solidarity** between generations can also be organized, on the basis of either the long useful economic life of works or the geographic areas (city centers – suburbs, rural areas).

Proposal:

On average, in the case of utilities or essential services, operating receipts should cover at least operating costs (not including capital expenditures).

Only “commodities” or “facilities” should normally cover the full cost of service.

4. Rates can be equitably assigned:

- ◆ This is one way of demonstrating solidarity among geographic areas or among socio-economic groups within a given urban area or region (concern for fairness).

5. While international assistance should also be mobilized, it might be better to:

- ◆ **First set up an equitable assignment** of rates in a local area (solidarity on the local level),

- ◆ And then on the **national level** (budgetary subsidies),
 - ◆ And finally, on the **international level** (concessional loans and grants).
- 6. Since service is essential, there is a major risk of arbitrary tariff policies in periods of hyperinflation and currency devaluation.**
- If financing is in **hard currencies** (dollars), failure to respect contracts clauses undermines the viability of these contracts (e.g. the case of Buenos Aires).

Three conclusions should be drawn:

- ◆ **Dissociate infrastructure financing**, to be **undertaken and financed by the public sector** (at least for the most expensive basic infrastructure works), from **service operations**, which can be entrusted to the **private sector** and should be financially balanced;
- ◆ **Mobilize local savings** as much as possible by providing a minimum level of guarantees; this is often an abundant source of financing; e.g. through guarantee funds under French development assistance (AFD).
- ◆ Involve **local or national private-sector operators** as much as possible, depending on their capacity.

How to combine reforms to achieve success

- 1. Train the different players and give them responsibilities:**
 - ◆ Public-sector supervision (or governance);
 - ◆ Professional competence (capacity building).
- 2. Decentralize responsibilities:**
 - ◆ The role of local government in managing essential services is critical;
 - ◆ Define the legal and regulatory framework on the national level;
 - ◆ Decentralize both responsibility and financing;
 - ◆ Permit direct loans to local government (with guarantee mechanisms and risk-sharing [e.g. IFC or EBRD]).

3. **Liberalize:** open up to **competition**.
4. Link the private sector to the public interest – **PPP**.
5. **Privatize:** What does it mean? Should one:
 - ◆ Also privatize infrastructure?
 - ◆ Sell existing infrastructure instead of financing future infrastructure?
 - ◆ French law prohibits entry fees (“key money”) for water, sanitation and waste removal.
6. **Fight corruption!**

How to profit from competition in utilities

1. Distinguish among:

- ◆ Competition within the market;
- ◆ Competition for access to a market with few players (portable telephony, market to provide services with the possibility of a jointly-used infrastructures);
- ◆ Competition for a market -- access to a natural monopoly: exclusive rights opened to competitive bidding.

An independent regulator is necessary, at least in the first two cases.

2. **Dissociate infrastructure from services** (unbundling)
 - ◆ Access by third parties to networks;
 - ◆ Greater importance of public-sector supervision of infrastructure (long-term, irreversible), as opposed to services open to competition.
3. **Favor incentive mechanisms included in contracts**, since these are at least as effective as the initial competition for contract award in ensuring operational efficiency.
4. Long-term contracts are perforce **incomplete**. A **mechanism to permit periodic adjustment of the contract** in the light of changes in external conditions is necessary.

5. Avoid **arrangements** that distort competition. **Do not make choices based on a single criterion** (“Don’t pick your wife on the basis of the size of the dowry”).

In fact, too many competitors encourages arrangements among them.

6. Take the **costs of responding to calls for tender** into account; these are not negligible for complex global contracts.

If the cost is very high, provide **compensation** to the competitors, **limit their number** and **respect their intellectual property**.

How to deal with corruption (without being either naïve or cynical)

There are different forms of corruption:

1. **Widespread minor corruption** (in the public sector public in some countries)
 - ◆ Employees working part-time for full pay;
 - ◆ Non-transparent recruitment (nepotism);
 - ◆ Users who pay only part of their bills, perhaps by corrupting employers or executives;
 - ◆ Managers of operating companies or political authorities benefiting from special “generosity” (bribes).

A **virtuous circle** can be initiated by entrusting management to a professional operator:

- Employees are better trained, more productive and better paid;
- Higher-quality service encourages users to pay;
- Greater self-financing.

The improvement factor can reach up to 3 to 4: Twice the revenues for half the expense.

Hence, **patronage** relationships between political authorities and public-sector managers should be broken, whether these involve:

- ◆ ties with employees,
- ◆ ties with users or customers (often the rich or government agencies) that do not pay.

2. Corruption in awarding, monitoring and possible renegotiation of contracts (a main concern of the World Bank).

Do not focus only on the awarding of contracts, but also on their execution and supervision; these can favor corruption at different levels.

Prevention:

Transparency, democracy, penalties.

Rely on the a company's reputation and capacities (references); avoid “kamikazes” and “sharks.”

3. Major corruption at the highest national level:

- ◆ Oil, arms, major contracts, privatizations...“kick-backs,”
- ◆ Links to **influence-peddling in government,**
- ◆ Rackets?

4. Large-scale **Mafia-type phenomena** that have developed in many countries since the fall of the Berlin Wall.

Conclusion:

There is no **optimal solution** in procurement, since there are contradictions between **efficiency** in placing orders or awarding contracts and fairness in access to these: decision-makers must fulfill their **responsibilities** in a clear and transparent way.

Corruption is **systemic by nature**: It is key to better understand its underlying economic and social mechanisms in order to be able to **make progress** in attacking its most important manifestations as a matter of priority, while addressing simultaneously all its aspects.