Capacity Building Workshop on Partnerships for Improving the Performance of Water Utilities in Africa Region
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Contractualization
Making Public Utilities More Accountable

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Session outline

⬥ Introduction: why 'contractualize' ?
- ▪ **The fundamentals and a look at recent history**
- ▪ **The new generation of public-public contracts**

⬥ The contractual arrangement
- ▪ **Structuring options**
- ▪ **Critical factors for implementation**

Governance issues in public utilities: some economic jargon…

- ◆ **Complex agency chain:**
  - ▪ **Who makes the decision?**
- ◆ **Common agency problem**
  - ▪ **Various parts of governments have different objectives**
- ◆ **Result is widespread inefficiency:**
  - ▪ **Decisions rarely based on public interest**
  - ▪ **Financial viability is elusive, as cost of social & environmental mandates are not made apparent**

No wonder public water utilities are easily abused…

- ◆ **With ambiguous and conflicting objectives, managers ends up having discretion to run firm according to special interests**
  - ▪ **Little disclosure (of what?)**
  - ▪ **Little accountability (to whom? for what?)**
- ◆ **Government can easily meddle into operational management**

Is this really a legal & enforcement issue?

Recent experience suggests that

**THE PROCESS OF INTRODUCING,
UPDATING, AND
MONITORING**

is at least as important as enforcement and accountability

The importance of the design process (1)

- **Spelling out the trade-offs and face tough sector issues:**
  - **What is realistic in medium term?**
  - **Who is responsible for what?**
  - **What resources must be allocated?**
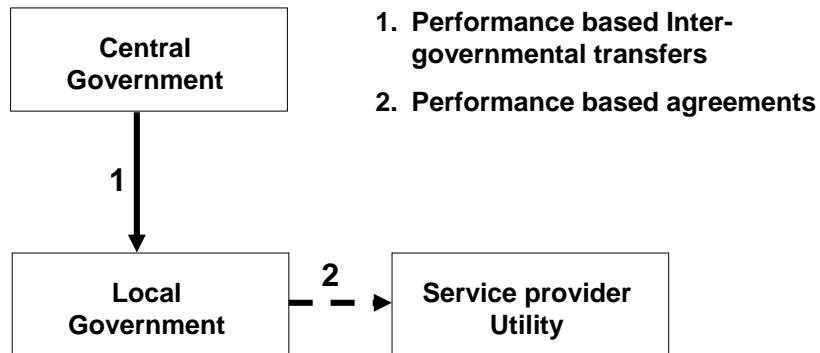 - **Make fully apparent the cost of social & environmental mandates**

The importance of the design process (2)

- Develop communication between various government entities:
  - Joint analysis
  - Reach consensus and/or formal decision

- Build climate of confidence with other stakeholders

  ➔ Set the stage for rational debate, in a sector where this is often lacking …

A "cultural revolution":
refocus reporting on services delivery to the population / civil society

➔ Focus on performance, not procedures

- Introduce indicators for service delivery and cost efficiency
- Realistic targets (no wish list) based on acknowledged trade-offs
- Independent monitoring with different layers:
  - Professional auditors
  - Stakeholders committee

Try "the carrot" instead of "the stick": incentive-based financial transfers

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┌──────────────────┐        1. Performance based Inter-
│     Central      │           governmental transfers
│    Government    │
└──────────────────┘        2. Performance based agreements
         │
       1 │
         ▼
┌──────────────────┐   2    ┌──────────────────┐
│      Local       │ ──────▶│ Service provider │
│    Government    │        │     Utility      │
└──────────────────┘        └──────────────────┘
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Structuring
the Relationship between Central, Local Government and the Service Provider

A definition ?

Contractualization

establishing a <u>contractual relationship</u> between public entities, namely state and local authorities, and services providers (public, private or community operators), in order to <u>empower</u>, and create incentive and accountability structures within, a <u>public utility</u> thereby improving service delivery and increasing efficiency of operations.
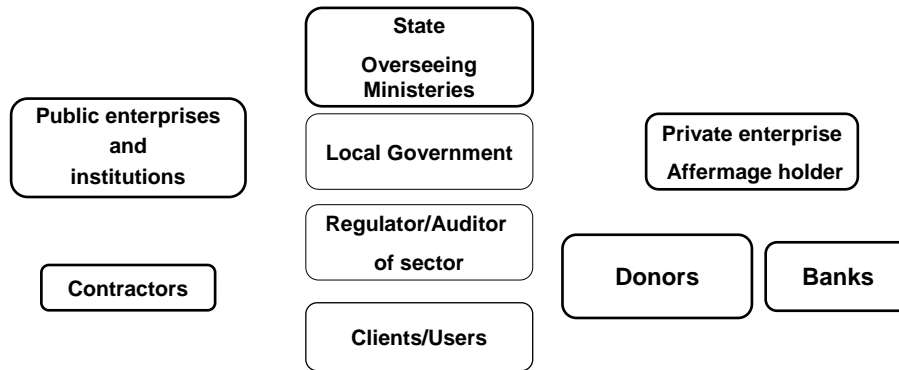
A process ?

Contractualization (or: "institutionalization")

is ***a process that involves the creation and implementation of a chain of contracts*** *and/or other kinds of formalised agreements, linking the (majority of) stakeholders in a complex social system, that are set up to improve the performance and extension of essential public services.*

Contractual Arrangements

- ♦ **A chain of complex and interdependent contracts**

- ♦ **A multitude of actors and stakeholders**

- ♦ **Fragile equilibriums which require adaptation**

- ♦ **In a stable institutional and regulatory environment, appropriate and flexible**
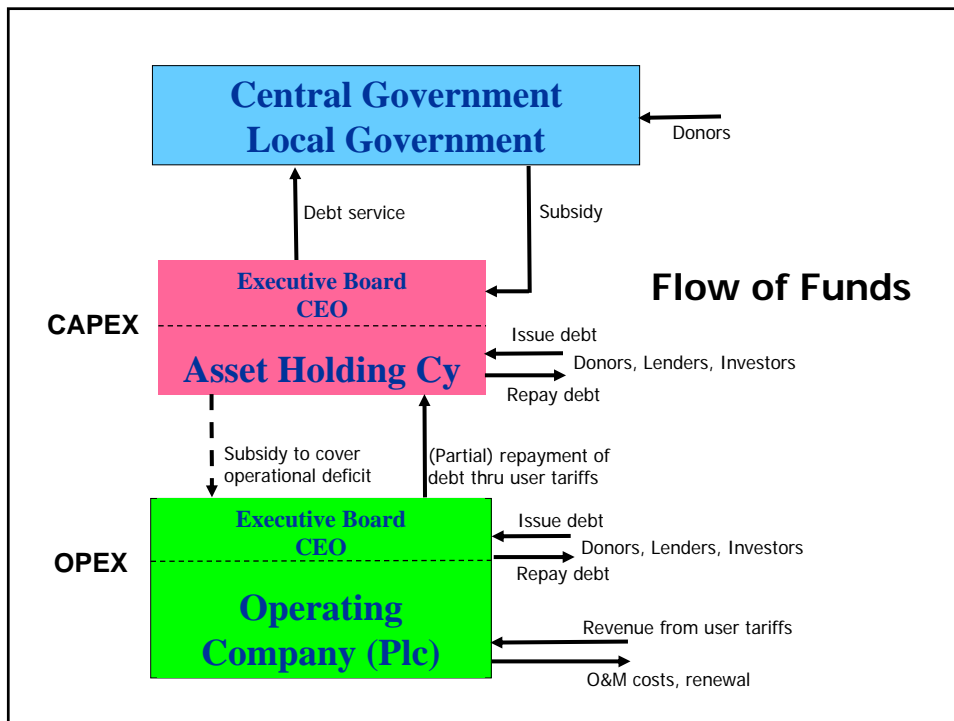
Actors in contractualization

State

Overseeing Ministeries

Public enterprises and institutions

Local Government

Private enterprise

Affermage holder

Regulator/Auditor of sector

Contractors

Donors

Banks

Clients/Users

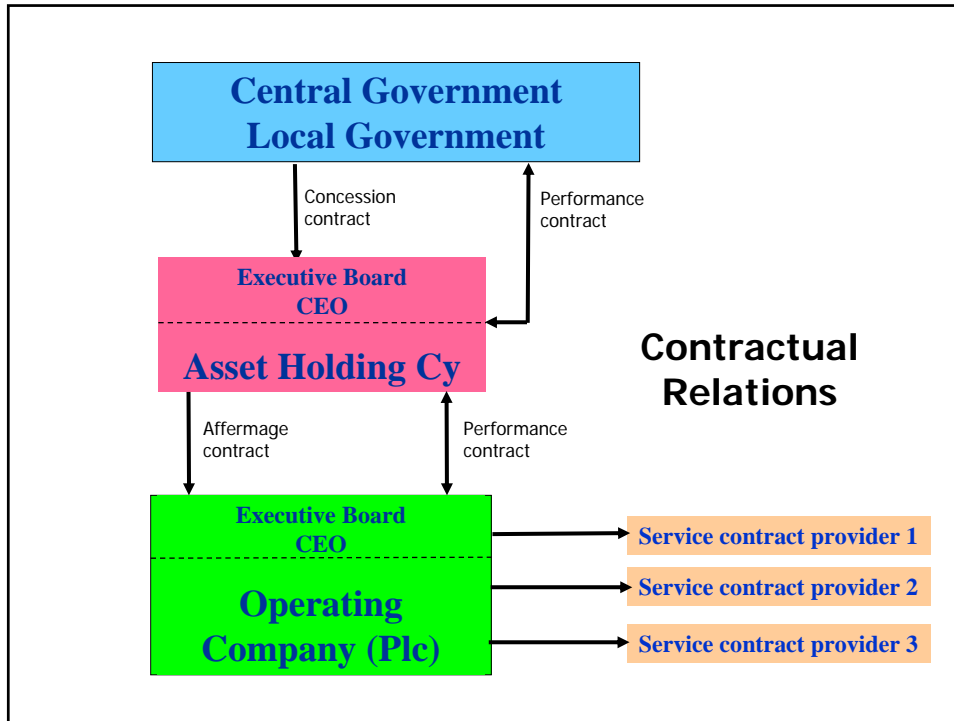**A multitude of actors and stakeholders**

Challenge

Choosing an Institutional Structure with Managerial and Technical Autonomy

while keeping the Government and Provider honest

Contractual Relations

Central Government
Local Government

Concession contract

Performance contract

Executive Board
CEO

Asset Holding Cy

Affermage contract

Performance contract

Executive Board
CEO

Operating Company (Plc)

Service contract provider 1
Service contract provider 2
Service contract provider 3

Flow of Funds

Central Government
Local Government

Donors

Debt service

Subsidy

CAPEX

Executive Board
CEO

Asset Holding Cy

Issue debt
Donors, Lenders, Investors
Repay debt

Subsidy to cover operational deficit

(Partial) repayment of debt thru user tariffs

OPEX

Executive Board
CEO

Operating Company (Plc)

Issue debt
Donors, Lenders, Investors
Repay debt

Revenue from user tariffs
O&M costs, renewal

Elements and necessary conditions

♦ **The term contractualization implies:**

- **Negotiated commitments, most often reciprocal, to be subscribed and abided by.**

- **An «attitude» by partners and stakeholders (mind set, behaviour, including the means to sustain).**

- **«Judges» controlling the implementation of commitments taken, and the application of sanctions, which should be seen as legitimate in the eyes of parties concerned.**

Putting in place a Public-Public contract: how to avoid mistakes ?

♦ **Emphasis on process and common sense**

♦ **Keep it simple: the key idea is to**
  - **focus actors on objective goals, and**
  - **acknowledge trade-offs**

♦ **Small set of key indicators**

♦ **Reporting and disclosure is key:**
  - **Format/frequency**
  - **Layers of monitoring**

**One warning:
the danger with public-public contracts**

- **Should not be used as an excuse for avoiding tough issues (e.g. India)**

- **Successful contractualization cases had full ownership from Government (e.g. Uganda, Haiphong/Vietnam, Burkina Faso)**

- **Donors must insist on them being part of a wider package addressing issues of tariff sustainability and governance**

Successful Contractualization requires a gradual approach

- **Start with informal agreements laying out responsibilities and targets (business plan)**
- **Introduce simultaneous improvements in the sector framework:**
  - **Operational autonomy**
  - **Human Resources (HR) practices (start with management)**
- **Only then introduce formal agreements**
  - **Bonuses before sanctions**

Contractualization is a tool to …

- ♦ **Protect general interest**

- ♦ **Promote access to water and sanitation services for all**

- ♦ **Promote an improved governance and the introduction of practical tools to ensure and guarantee**

- ♦ **Responsabilize stakeholders**

- ♦ **Introduce a change management process**

- ♦ **Create enabling conditions to build capacities for an improved response to user demand**

Thank you