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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

1. Performance based Inter-governmental transfers
2. Performance based agreements

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Structuring the Relationship between Central, Local Government and the Service Provider

A definition?

Contractualization

*establishing a contractual relationship between public entities, namely state and local authorities, and services providers (public, private or community operators), in order to empower, and create incentive and accountability structures within, a public utility 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

A multitude of actors and stakeholders

Challenge

Choosing an Institutional Structure with Managerial and Technical Autonomy while keeping the Government and Provider honest
Central Government
Local Government

**Contractual Relations**

- Concession contract
- Performance contract
- Affermage contract
- Performance contract

**Operating Company (Plc)**

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

**Flow of Funds**

- Debt service
- Subsidy
- Issue debt
- Repay debt
- (Partial) repayment of debt thru user tariffs

CAPEX

- Subsidy to cover operational deficit
- Issue debt

OPEX

- Revenue from user tariffs
- O&M costs, renewal

Donors

- Repay debt
- Donors, Lenders, Investors

Donors

- Issue debt
- Lenders, Investors

Donors, Lenders, Investors

- Repay debt
- Donors, Lenders, Investors
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