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## Putting Water Back into Public Hands

Edited by Martin Pigeon, David A. McDonald,  
Olivier Hoedeman and Satoko Kishimoto



# Remunicipalisation: Putting Water Back into Public Hands

Edited by Martin Pigeon, David A. McDonald, Olivier Hoedeman and Satoko Kishimoto



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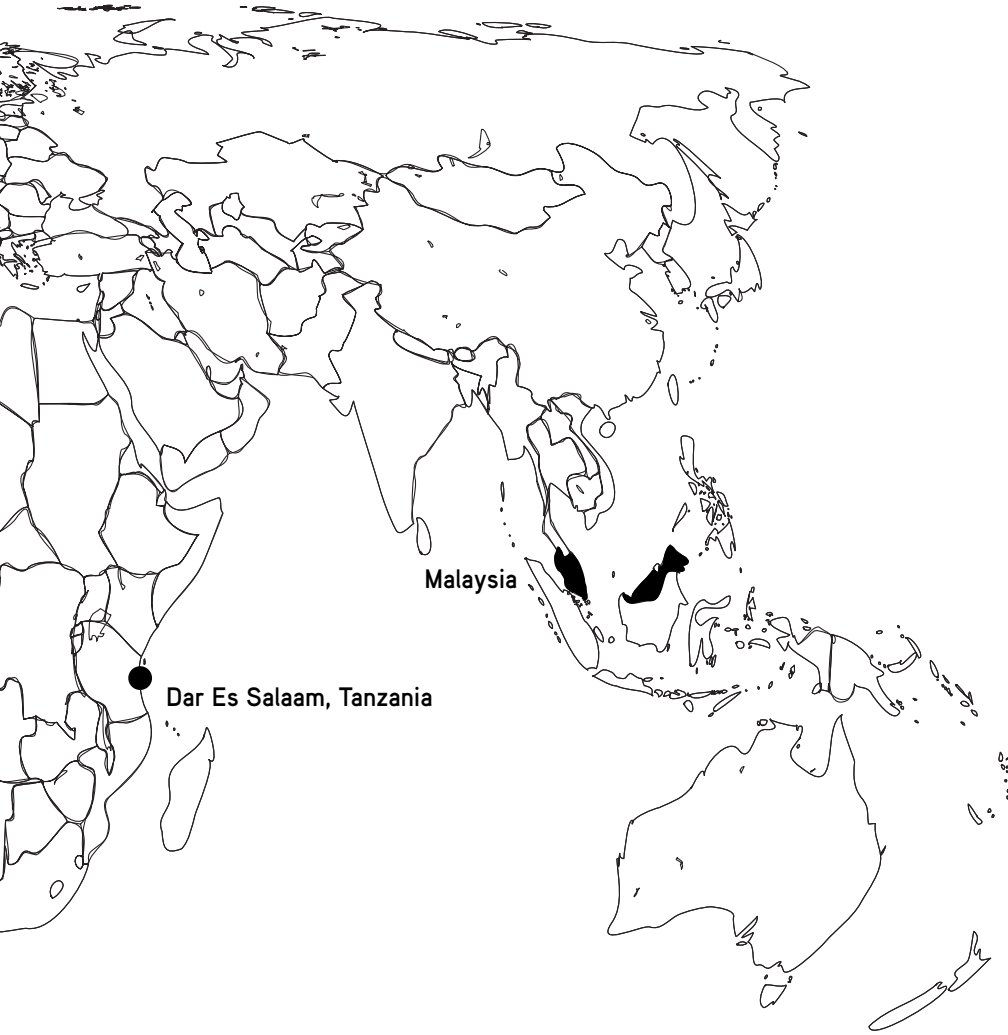
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## TABLE OF CONTENTS

<b>Case Study Locations</b>	6
Chapter One	
<b>Remunicipalisation Works!</b>	8
David A. McDonald	
Chapter Two	
<b>Une eau publique pour Paris: Symbolism and Success in the Heartland of Private Water</b>	24
Martin Pigeon	
Chapter Three	
<b>From Fiasco to DAWASCO: Remunicipalising Water Systems in Dar es Salaam, Tanzania</b>	40
Martin Pigeon	
Chapter Four	
<b>Aguas Públicas: Buenos Aires in Muddled Waters</b>	58
Daniel Azpiazu and José Esteban Castro	
Chapter Five	
<b>Who takes the risks? Water Remunicipalisation in Hamilton, Canada</b>	74
Martin Pigeon	
Chapter Six	
<b>Soggy Politics: Making Water ‘Public’ in Malaysia</b>	90
Martin Pigeon	
Chapter Seven	
<b>Looking to the Future: What Next For Remunicipalisation?</b>	106
Olivier Hoedeman, Satoko Kishimoto and Martin Pigeon	
<b>About the Authors</b>	113
<b>Get Involved!</b>	114
<b>Index</b>	115

# Case Study Locations





## Chapter One

# Remunicipalisation Works!

by David A. McDonald

It's not an easy word to say, but remunicipalisation is a growing and exciting trend in the water sector. Defined as the transfer of water services from private companies to municipal authorities, remunicipalisation shows that the public sector can outperform the private sector and can be an effective water provider anywhere in the world. This book reviews five recent examples of remunicipalisation – in Paris (France), Dar es Salaam (Tanzania), Buenos Aires (Argentina), Hamilton (Canada) and in a series of Malaysian municipalities – and discusses why it is happening, how the transformations take place, how well the services have performed under public control, and lessons learned from these experiences.

The reasons for remunicipalisation are diverse, but stem in no small part from the failures of water privatisation. Even the World Bank has called for a 'rethink' of privatisation policies,<sup>1</sup> having recognised the regulatory problems associated with multinational water providers, and having seen the effects of a profit-driven service delivery model on workers, low-income households and the environment.

As a result, there has been less direct privatisation of water services since the 1980s and 90s, but the commercialisation trend continues, largely through the use of public-private partnerships.<sup>2</sup> In effect, the World Bank and many United Nations agencies still advocate for private sector participation in water services and continue to invest in think tanks, conferences and publications that promote and finance private involvement in water services around the world.<sup>3</sup>

Not surprisingly, resistance to these commercialisation trends continues as well. From street protests in Cochabamba, Bolivia, that forced multinational water companies out of the city in 2000, to grassroots movements protecting groundwater supplies from bottled water companies in India and the US, to research and academic writing about the problems of water commodification, mobilisation against the practice of water privatisation remains strong.



Municipalities are increasingly involved in this resistance, in part because they have witnessed the effects of privatisation first-hand, making this level of government a critically important player in public-private debates. Although some municipalities remain supportive of private sector involvement in water, many are frustrated with the broken promises, service cut-offs to the poor, the lack of integrated planning, and pressures from international financial institutions that force them to contract out to private firms. As a result, many municipalities have begun to push back. This is not (yet) a complete reversal of the privatisation tide, but it is a riptide of sorts, inspiring practitioners and policy advocates from around the world to explore a new counter-narrative to the neoliberal ideology of market-based service delivery solutions.<sup>4</sup>

Inspiration is not enough, however. Discussions of remunicipalisation have been energetic but anecdotal, with little understanding of the commonalities between various experiments and no clear research methodologies for evaluating their results. Although each remunicipalisation experience is different it is essential that we develop a comparative understanding of why they have happened (or not), how they operate and whether they can and should be attempted elsewhere. This book is therefore an effort to advance academic and policy debates about public water services by tightening our conceptual understanding of remunicipalisation and situating the discussion within a larger body of literature on ‘alternatives to privatisation’.

Another objective is to be ‘critically positive’ about remunicipalisation, which is to say that we want to celebrate public water provision but in ways that recognise the constraints and limitations of ‘public’ reforms in the hope of identifying means by which remunicipalisation can be more successful. There are concerns with all of the remunicipalisation experiences we investigated for this book and room for improvement on a number of fronts. It would be unproductive to ignore or downplay these issues.

It should also be noted that this is not the first time the world has witnessed (re)municipalisation debates. Most contemporary water services around the world started as private enterprises (as early as the mid-1800s), but as the inefficiency of private sector providers became increasingly evident, and as private companies denied water services to the poor (contributing to outbreaks of cholera and other illnesses), local governments began to municipalise these services for the first time. The city of London, for example, went from a “nine-headed monopoly” in the 1850s, to a centrally coordinated public utility in the early 1900s.<sup>5</sup> No less a figure than liberal economist John Stuart Mill criticised the byzantine inefficiencies of balkanised private sector supply, noting that “a business of real public importance can only be carried on advantageously upon so large a scale as to render the liberty of competition almost illusory...it is much better to treat it at once as a public function.”<sup>6</sup> It was an error, he argued, to believe that competition among utility companies actually kept prices down. Collusion was the inevitable result, not cheaper prices.

The first prominent city manager in the UK to endorse this philosophy and to apply it in practice was the Liberal Radical Joseph Chamberlain. As mayor of Birmingham in the 1870s, he committed himself to this new civic gospel: “All monopolies which are sustained in any way by the State ought to be in the hands of the representatives of the people, by whom they should be administered, and to whom their profits should go.”<sup>7</sup> Chamberlain succeeded in bringing gas and water under municipal control, the former, primarily for its profits, the latter, in pursuit of long-overdue public health reforms. “The Water Works,” Chamberlain argued, “should never be a source of profit, as all profit should go in the reduction of the price of water.”<sup>8</sup>

In some respects, then, the debates about remunicipalisation today are the same as those that took place a century ago. Municipalities remain concerned about the power of private corporations over essential services in their towns and cities, and the implications this has for social and environmental welfare. We are also witnessing similar concerns about financial crises and the growing polarisation of wealth, contributing to a healthy skepticism of market reforms in general and reinvigorating resistance to privatisation in particular.

Less optimistically, the parallels with these earlier municipalisation efforts raise troubling questions about the nature of the state, and in whose interests ‘public’ water is actually being run – particularly when it comes to ‘corporatised’ water utilities run on private-sector operating principles, a point we return to repeatedly in the book. Nevertheless, motivation can be taken from the fact that water privatisation was once before seen as a dismal failure at the municipal level and a comparable trend is recurring today.

### **Choice of case studies**

Decisions about which sites to examine in this study were based on several criteria. First, we opted for locations where remunicipalisation had been fully completed, and where sufficient time had elapsed to draw reasonable conclusions about their operation – although each case is still very much a work-in-progress. Second, we chose a geographically disperse set of examples, with sites in Europe (Paris), Africa (Dar es Salaam), Latin America (Buenos Aires), North America (Hamilton), and Asia (Malaysia). Third, we chose sites with very different political, economic and geophysical contexts.

The Malaysian case is not, strictly speaking, one of remunicipalisation, due to the fact that it brought about a national-level set of reforms that affected many different municipalities. We included it because of this multi-scalar feature, however, given how it illustrates the potential for nation-wide reforms to bring change to a large number of municipalities instead of scattered, stand-alone efforts.

The fact that the examples are drawn from the North and the South serves to illustrate the global nature of this remunicipalisation trend and some of the universalities associated with it. This North-South focus also highlights ongoing resource and power differentials between governments in higher- and lower-income countries, with the cities of Hamilton and Paris having much greater fiscal and infrastructural capacity to bring water in-house than municipalities in Argentina, Malaysia and Tanzania, where human and financial resources for water services are more scarce. Similarly, non-governmental organisations and labour unions in the North tend to be better resourced for resistance to privatisation and promoting alternatives than their counterparts in the South, and often have more political space to air their views.

One lead that cities in the South have in this regard is the more highly charged nature of water debates and the life-and-death nature of problems associated with water privatisation. Scars of e-coli infection in Canadian municipalities in the early 2000s helped catalyse support for remunicipalisation in Hamilton, but these concerns pale in comparison to the disease burdens and service cut-offs associated with privatised water services in Argentina, Malaysia and Tanzania where large percentages of the population have little or no access to basic water and sanitation and where diarrhea, cholera and other illnesses remain major causes of concern. It is in tragic environments such as these that resistance to privatisation often burns hottest, and where the potential for longer-term (grassroots) political commitment to change is strongest. Tough opposition does not necessarily lead to successful alternatives to privatisation, but it can certainly speed change along.

## Research methods

As noted above, this is the first comprehensive and comparative study of contemporary water remunicipalisation to be undertaken. But with innovation comes methodological challenges, the most important of which is the lack of an established remunicipalisation literature to draw on. Complicating matters is the dearth of literature on alternatives to privatisation in general, with the vast majority of anti-privatisation writing being a critique of privatisation rather than an exploration of alternative public service options.

Nevertheless, research for this book has benefited from methodologies that have been developed for previous work undertaken by the groups coordinating this study – Corporate Europe Observatory (CEO), the Municipal Services Project (MSP) and Transnational Institute (TNI). Extensive studies by the Reclaiming Public Water Network – coordinated by TNI and CEO, and involving dozens of organisations around the world – provided a rich background of empirical insights into remunicipalisation and an extensive network of contacts,<sup>9</sup> while the development of new research methods on ‘alternatives

to privatisation' more broadly provided additional coherence and transparency to our comparative studies.<sup>10</sup>

The point of departure in the research was to ask questions about the history of the original privatisation in each municipality, and the events and conditions that led to its demise. This historical overview was drawn based on interviews with people involved in the privatisation, reviews of secondary literature, assessments of budget documentation, and so on. Interpretations of privatisation experiences are subject to debate, of course, but in each case the episode has left significant structural, financial and ideological legacies that shaped the direction of remunicipalisation and often constrained the potential for public sector success.

More difficult was the evaluation of the remunicipalisation experience itself. For this assessment we drew on a normative set of 'criteria for success' that had been developed for the study of alternatives to privatisation referred to above.<sup>11</sup> Our objective was to establish a universal set of criteria against which we could evaluate the success (or otherwise) of a remunicipalised service, while allowing for differences between the case studies. As Hachfeld et al note, "there is no exemplary model of 'good' or 'progressive' public water management,"<sup>12</sup> but it is important to establish clear and explicit criteria against which one can assess the outcomes of remunicipalisation and compare the experiences across time and place.

The criteria we have selected should come as little surprise to those familiar with the debates about privatisation; many are the polar opposites of what is seen to be wrong with privatisation, such as lack of transparency, inequality and unaccountability. We have also used criteria that are unique to public services, such as 'public ethos' and 'solidarity', and opted for criteria (such as equity) with sufficient elasticity of meaning to allow for variations in interpretation. Finally, our criteria are also intended to challenge or rule out many neoliberal interpretations of success, such as marketised notions of 'efficiency' that limit discussions of service performance to narrow financial terms.

The research criteria we employed are summarised in Table 1.1. Not all of these criteria were examined in depth in every case, but interviews and literature reviews were informed by these measures of success and allowed us to develop data on the operating principles and practices of the remunicipalised water services. Further investigation will reveal more detailed information, and the fragile nature of some cases suggests that current performance could change on short notice. Nevertheless, the information collected here offers a more transparent and comprehensive glimpse into remunicipalisation than has been available to date. In this regard, the book should be seen more as research-in-progress than as a final statement on remunicipalisation.

Finally, four of the case studies were undertaken by Martin Pigeon from CEO who travelled to Dar es Salaam, Hamilton, Malaysia and Paris for the research. The fifth study on Buenos Aires was conducted by Daniel Azpiazu and José Esteban Castro, with the same terms of reference and with close research collaboration and editing from the research team. Fieldwork began in late 2010 and was completed by mid-2011.

## Key findings of the research

As with any complex system the devil is in the details. Nowhere is this maxim truer than in the politically charged environment of water remunicipalisation. It is essential, therefore, that each case study be taken on its own merit and be read closely. There are, however, some common findings that can be highlighted here, summarised into what we consider to be 'positive' and 'critical' lessons. The former showcase the most encouraging results from the research, while the latter highlight more ambiguous outcomes, such as the ongoing presence of a commercialised logic in public water management. Neither are inevitable products of remunicipalisation but both help to advance our conceptual and political understanding of this growing trend in the sector.

## Positive lessons

### *Remunicipalisation works*

Though not perfect and never guaranteed, the examples in this book demonstrate that water services can be transferred from private to public ownership and management with little disruption of service and with extremely positive results. In each case the remunicipalised entity offered more equitable, more transparent and more efficient services than the private sector provider that preceded it, with a higher quality of services and with better long-term sustainability.

Financially, there were significant direct savings for most of the municipalities – some €35 million in the first year in Paris, and about C\$6 million in the first three years of remunicipalisation in Hamilton – some of which was realised immediately when profit-taking for private management fees was removed. Efficiency gains were also achieved through good, sensible public management. Moreover, short-term savings boosted re-investments in longer-term infrastructure development, which will in turn help avoid future cost burdens associated with the health and environmental disasters of privatisation, much of which was borne by the state in the past.

Just as important as the cost savings are the philosophical shifts that have taken place in water services: the perspective changed from a narrow, profit-oriented one to one involving a wider range of social and political objectives. From ensuring water access for the

**Table 1.1 Criteria used to evaluate remunicipalisation**

Equity	<ul style="list-style-type: none"> <li>· Is availability of the service equitable for different social groups?</li> <li>· Is the quality and quantity of the service equitable?</li> <li>· Are prices equitable?</li> <li>· Is equity formalised, legalised or institutionalised in some way?</li> </ul>
Participation in decision making	<ul style="list-style-type: none"> <li>· Is the depth and scope of participation adequate?</li> <li>· Is participation equitable?</li> <li>· Is participation formalised, legalised or institutionalised in some way?</li> <li>· Is the model of participation sustainable?</li> </ul>
Efficiency	<ul style="list-style-type: none"> <li>· Is the service delivered in a financially efficient manner?</li> <li>· Are adequate investments being made in long-term maintenance?</li> <li>· Do efficiency gains undermine other potentially positive outcomes?</li> <li>· Do efficiency gains take into account other services and/or levels of government?</li> </ul>
Quality of service	<ul style="list-style-type: none"> <li>· Is the overall quality of the service good?</li> <li>· Is quality improving?</li> </ul>
Accountability	<ul style="list-style-type: none"> <li>· Are service providers accountable to end users?</li> <li>· Is accountability formalised, legalised or institutionalised in some way?</li> </ul>
Transparency	<ul style="list-style-type: none"> <li>· Does the general public understand the operating mandates of the service provider?</li> <li>· Are decisions about service delivery regularly communicated to the public?</li> <li>· Is transparency formalised, legalised or institutionalised in some way?</li> </ul>
Quality of the workplace	<ul style="list-style-type: none"> <li>· Do frontline workers participate in the policy-making of the service?</li> <li>· Are workers paid a fair salary and benefits?</li> <li>· Are there adequate numbers of workers to ensure quality, safety, sustainability?</li> <li>· Are there good relations between frontline workers, managers and end users of the service?</li> <li>· Is there equity among workers?</li> </ul>
Sustainability	<ul style="list-style-type: none"> <li>· Are there sufficient financial resources available to ensure successful continuity of the service?</li> <li>· Is there sufficient political support for remunicipalisation at different levels of government?</li> <li>· Is the service using natural resources in a sustainable way?</li> </ul>
Solidarity	<ul style="list-style-type: none"> <li>· Does the service help build solidarity between workers, community, bureaucrats, politicians, NGOs, end users?</li> <li>· Does the service help to build solidarity between different service sectors (e.g. with public health officials)?</li> <li>· Does the service help to build solidarity with other levels of state?</li> </ul>
Public ethos	<ul style="list-style-type: none"> <li>· Does the model help to create/build a stronger 'public ethos' around service delivery?</li> <li>· Does the model promote thinking and dialogue about concepts of public ownership and control?</li> <li>· Does the service model explicitly oppose privatisation and commercialisation?</li> </ul>
Transferability	<ul style="list-style-type: none"> <li>· Is the model transferable to other places (in whole or in part)?</li> </ul>

poor in Buenos Aires, to a reunified and consistent management of the entire water cycle in Paris, many remunicipalised water entities have demonstrated their ability to think beyond their sectoral boundaries and accounting silos to be more holistic in their planning and action. Contrary to the privatisation argument that ‘politics’ is bad for water management, these public providers have demonstrated that politics is an inevitable and necessary part of decision making and service delivery. It is a question of how these politics are managed and the nature of the politics being discussed.

Staff morale has also improved among frontline workers and management, notably in Buenos Aires and Hamilton. Instead of sitting on the sidelines in frustration as private water companies fail to live up to their expectations, public water employees are more engaged in the planning and operation of water services than they were in the past and feel part of a larger public service network and ethos. We do not want to overstate this philosophical change: water workers in Paris have been largely unaffected by remunicipalisation, and in Malaysia trade unions have had little involvement in the discussions about water reforms. It is also difficult to measure criteria such as ‘work satisfaction’, and there are additional concerns about the depth of commitment that workers have to notions of ‘publicness’ (discussed below). Nevertheless, the pride-of-work expressed by many of the employees interviewed for this research was palpable and suggests a commitment to public water services that goes beyond the narrow financial and technocratic concerns that dominate private water management.

### *Shifts to public worldwide*

The fact that remunicipalisation is taking place on every continent serves to demonstrate that it can happen anywhere. The Paris remunicipalisation is particularly note-worthy given that city’s symbolic role in water privatisation; two of the largest and most influential private water companies in the world, Veolia and Suez, are headquartered in Paris and have run the city’s water services at different stages since 1860. It was not an easy transition, but if decades of private sector inertia and entrenched corporate power can be overcome in Paris there is hope for most other places in the world.

The growing phenomenon of remunicipalisation also challenges the myth that privatisation is irreversible. Often used, understandably, as a tactic by anti-privatisation activists to argue that water should not be privatised in the first place, there is a need to revisit the full import of this claim. More importantly, there is a need to revisit what we mean by ‘public’ water, particularly in countries in the global South where public services have often been under-funded, unequal, non-transparent and open to corruption. In other words, remunicipalisation should not be seen as a linear, two-way street between polarised notions of private versus state delivery, but rather as a remaking and rethinking of what it means to be public, and a revisiting of how we define successful water services.

Herein lays a key challenge for those wanting to remunicipalise their water systems. As encouraging as it may be that so many places are taking water services back from the private sector, there is no blueprint for how it is done and old-school models of top-down state planning may not be seen as progress at all. This challenge does not make it any less urgent to remunicipalise, but it does raise the bar in terms of what we should expect from a 'successful' public transition.

It should also be emphasised that remunicipalisation can be managed completely at a local level. Although successive national governments were involved in the case of Dar es Salaam, and even more so in the multi-sited case of Malaysia, remunicipalisation can occur within the jurisdictional boundaries of a local authority, making it easier for local groups to mobilise and advocate for change. Small towns and district municipalities can also bring water back in-house.

Having said that, watersheds often cross political boundaries, and under-funded municipalities are increasingly desperate for capital and operating revenues, requiring some intergovernmental coordination. There is also merit in thinking in national or regional terms when considering a mass remunicipalisation strategy, particularly in Europe where dozens of private water contracts will be coming up for review in the next few years (see the concluding chapter of this book for further discussion).

*Privatisation is its own worst enemy*

Helping the remunicipalisation trend is the failure of water privatisation, in all its guises. In four of the five cases in this book, it was the (near) collapse of privatisation that precipitated the move to remunicipalise. The situation was disastrous in two cases (Buenos Aires, Dar es Salaam) and problematic in two others (Hamilton, Malaysia). In Paris, private water provision was not a failure per se, but it was clear that the two private companies were reaping profits that could be kept in public hands. In all cases it became obvious that the private water companies put short-term profit ahead of long-term sustainability, and selective service delivery ahead of broad-based equity, treating citizens like consumers and water like a commodity.

Significantly, it was bureaucrats and politicians who recognised these problems and began to wonder why water had been privatised in the first place. Some of this awareness was triggered by a growing global critique of privatisation, but the local flaws were so glaring that even those who had previously supported privatisation turned against it. The fact that most of the senior policy makers interviewed for this research were generally in favour of market-oriented policies, and even supportive of privatisation in other sectors, makes this rejection of water privatisation all the more poignant and damning.



Privatisation, in other words, is its own worst enemy. Alternatives to privatisation are not so readily apparent, however, making it all the more important to discuss the details of remunicipalisation well in advance rather than scrambling to fill a corporate void after private provision collapses.

## Critical lessons

### *Reversing privatisation is not easy*

As encouraging as the momentum behind water remunicipalisation is, the technical and political difficulties associated with making this shift cannot be underestimated. Even where political will is strong and financial and technical capacity exists, reverting to public ownership and management is fraught with difficulties. There is institutional memory lost, degraded assets, poison pills left by the private company, communication and accounting systems that do not mesh with public sector systems, and so on. The case studies in this book provide the details of some of these challenges, but even these are only brief overviews of extremely complicated private-to-public transitions.

It is truly in these details that the devil of remunicipalisation is to be found. Political mobilisation to initiate such a process is difficult enough. The really demanding part comes with the grunt work on the ground to make it happen in practice. From equipment inventories, to amalgamating unions, to a change in service delivery cultures, remunicipalisation requires hundreds of people working long hours in stressful conditions under tight timelines. This is not the high profile politicking of resistance, but the tedious, behind-the-scenes grind of institutional and ideological reform that requires sustained attention to detail.

In some respects, remunicipalising water is even more difficult than creating water services from scratch. The deep asset deficit left by many private water companies means that municipalities are working with decrepit equipment and collapsing infrastructure that can be more expensive to repair than to replace and build anew. Private firms have also demonstrated that they can be politically difficult, sabotaging transition efforts to try and undermine the public provider. In each of the cases discussed in this book the private companies refused to release critical operational information, attempted to take the municipalities to court for breach of contract, or initiated counter-propaganda campaigns in an effort to undercut the credibility of the remunicipalisation initiatives. The fact that these anti-remunicipalisation efforts were unsuccessful in each case speaks volumes to the commitment of those involved in the transformation. It also lays bare the gritty, self-interested nature of private sector service providers and underscores the argument noted earlier that public water services should never be privatised in the first place (with the proviso, of course, that if they are privatised it can and should be reversed!).

Finally, it must be noted that donor funding cannot be relied on for remunicipalisation efforts. After decades of generous (and ongoing) political and financial support for privatisation from international financial institutions and bilateral donors, these ‘development’ organisations have effectively ignored the remunicipalisation trend. Funding for research on remunicipalisation is a drop in the bucket compared to what is spent on pro-commercialisation research and conferences by donors, while support for the implementation of remunicipalisation is practically non-existent (with the exception of limited funding for public-public partnerships from UN-Habitat<sup>13</sup>). In some cases international donors even have attempted to undermine remunicipalisation efforts, making the transition to public services an even more difficult one (such as the World Bank’s attempts to block remunicipalisation in Dar es Salaam, as discussed in Chapter Three of this book).

### *No guarantee of a ‘public ethos’*

Perhaps the most important lesson of all is what remunicipalisation tells us about the meaning of ‘public’. Many – if not most – of the officials interviewed for this research remain captive to the neoliberal logic of ‘new public management’ and resistant to welfare notions of service delivery such as cross-subsidisation for the poor. There has been a dramatic ideological shift over the past three decades in the training and management of public employees around the world – due in part to the ‘good governance’ agenda of the World Bank – and this trend is evident in each of the cases in this book. Entrenched neoliberal beliefs in market-based incentives, ring-fenced accounting, cost-reflexive pricing, and competition within and between government departments has transformed the ways in which people think about and manage public services, raising questions about the potential for deep reform in the public sector.<sup>14</sup>

Corporatisation is the term used to describe services that are wholly owned and operated by the state but run on private sector operating principles.<sup>15</sup> This arrangement typically involves the creation of a stand-alone water utility, directed by government but operating as a separate legal entity and largely dependent on its own revenues for operation. Cross-subsidisation from other sectors or levels of government is discouraged, while performance evaluation is generally conducted on narrow cost accounting terms and senior managers are paid based on the financial health of their ‘company’.

In some cases these corporatised managers are more dogmatic in their adherence to market principles than their private sector counterparts (partly due to the threat of privatisation if they do not prove themselves to be ‘efficient’). Such public service providers have denied services to low-income communities because of the ‘high costs’ of delivering them, and service cut-offs are often used to punish non-payment. Some providers simply limit services to low-income households to a pre-defined level of ‘basic needs’.<sup>16</sup>

Of the cases in this book, Dar es Salaam is the most problematic in this regard, with the new public managers of DAWASCO using language and policies that sound much like the private company they replaced. It is encouraging that water services are back in public hands, but DAWASCO management's failure to take equity and public engagement more seriously is a major concern. Low-income households continue to be marginalised and managers seem reluctant to think in more holistic terms, even flirting with ways to (re)introduce market incentives into the newly remunicipalised organisation.

Similar ideological currents were detected in the other case studies as well. The most common argument given by interviewees for remunicipalisation was not equity or public solidarity, but the fact that it 'saves money' and is 'more efficient' than a private contract. These are not unimportant criteria, of course. Nor is a concern with saving money necessarily neoliberal. These narrow financial preoccupations are, however, suggestive of a mindset still deeply embroiled in market ideology. Changing these attitudes will not happen overnight or with superficial technocratic reforms. Nor can it be forced on people. A different public sector philosophy will take sustained democratic efforts, possibly requiring a generational shift.

The good news is that a deeper rethink of the meaning of public is required in any event. As noted above, some public services have performed poorly or have been non-existent, making a rethink unavoidable. But even where the public sector has performed well – which describes the vast majority of water services in the global North – there are good reasons for thoughtful reform. Keynesian-era water services were often top-down and non-participatory and seldom as efficient as they could have been. They were also typically part of a larger Fordist model of development that aimed to support rapid growth in private sector industrialisation and market consumption, assisting corporate expansion and undermining environmental sustainability.<sup>17</sup>

Experiments with public participation in water services planning, worker cooperatives, community water systems and other innovative models of service delivery are challenging these older models of public water delivery and demonstrating the potential for water systems that push the boundaries of what we mean by public service.<sup>18</sup> Remunicipalisation cannot be an unquestioned return to what was offered before privatisation. It must be an improvement on what is meant by public and an expansion of the democratic terms of engagement.

### *Bringing in the state and organised labour*

The reality of complex and expensive water systems is such that governments must play a critical role in service delivery reform. Collaboration of state and non-state actors will be

easier in locations where senior bureaucrats and politicians have committed themselves to progressive change, but even where states seem impervious to cooperation mechanisms for state-society interaction it will be essential for successful transitions to public water entities.

Labour involvement is also critical. Public sector unions have been marginalised from many of the debates about remunicipalisation, despite the fact that frontline workers have important insights into operational challenges and opportunities and public sector unions have been at the forefront of opposition to privatisation at a global level.<sup>19</sup> Poor labour relations with managers are part of the problem here, but so too has antagonism between unions and social movements been a concern at times, with public sector workers sometimes seen as being primarily interested in protecting their own jobs. Some unions have made impressive strides in addressing these tensions and it is important that good relations with communities and social movements be fostered.<sup>20</sup>

Add to this mix a diverse collection of non-governmental organisations and academics attempting to intervene in remunicipalisation debates and there is an obvious need for better coordination of pro-public mobilisation. This is not to suggest that there should be a single voice or a simple consensus on what remunicipalisation should look like. The debates are too new and too complicated for that. Nor would we advocate the kind of blueprint models for reform that have motivated the single-minded rush to privatise. Remunicipalisation is necessarily different in every place, and versions of 'public' may take on very different hues. Nevertheless, there is a need for better coordination and sharing of ideas. Government officials, labour unions, social movements, NGOs and others will need to be part of this coordinated conversation. Research on remunicipalisation must take these internal political dynamics seriously.

## Conclusion

Remunicipalisation is an inspiring and promising development in the water sector. The five case studies provided in this book demonstrate the potential for reclaiming public water and remaking the public sector. Not all the lessons are positive, but each case provides insights into how private-to-public transitions take place, what could be changed or improved, and how these remunicipalisation experiments might be reproduced elsewhere. The fact that these transitions are taking place in very different locations and contexts is most encouraging of all.

The success of remunicipalisation in the water sector also begs the question as to whether it can work in other sectors such as health care, electricity and waste management. In some respects it already has. Privatisation has failed to deliver in all of these areas, and

citizens and managers have been pushing for a rethink of the commercialisation model. Hospitals and electricity services have been taken back into public hands, at all levels of government, and there are vibrant debates around the world about how various services can be returned to public ownership and control.<sup>21</sup>

Each service sector offers its own managerial, technical, geographic and political challenges, but there is much to be learned from inter-sectoral debate and dialogue. Water may be the most widely targeted sector for remunicipalisation, with much to offer policy makers and activists in other areas, but so too can water managers and researchers learn from reforms in health care, electricity, waste management, education, etc. After all, a more holistic sense of integrated public service delivery requires dialogue across sectors. If we are to escape the silo mentality imposed on public services by the logic of commercialisation we must start by avoiding it in debates about remunicipalisation.

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## Chapter Two

# Une eau publique pour Paris: Symbolism and Success in the Heartland of private Water

by Martin Pigeon





On November 24, 2008, the City Council of Paris, France, decided not to renew the municipal water supply service contract with Veolia and Suez, two French companies that dominate the global water market for municipal water services. They had been operating the French capital's water supply system jointly since 1985, and Veolia had been in charge of billing for the entire system since 1860. Instead, municipal authorities would create *Eau de Paris* as a public company under its direct supervision to operate the system from 2010 onward.

The two private companies' losing a contract at home was a major symbolic defeat. It also represented a significant challenge for Mayor Bertrand Delanoë, who had pledged to take back control of the city's waters during his electoral campaign; the remunicipalisation of a system on this scale had never been experienced in France, and there were tasks that the city administration had never performed, such as billing and customer relations. While the private companies were legally obliged to transfer responsibilities for the operation of the system, some property boundaries were not clearly defined, as was the case with information technology systems. Further, bringing together workers from multiple backgrounds and status into one structure was no simple task. The companies threatened to fight back, and did. Countless difficulties were likely to keep arising but the mayor and his team were convinced they could run the system just as well as the private sector, and even better. A year and a half after the official transition, results are proving them right: the transition was managed on time and with impressive financial outcomes.

As a case in point, Eau de Paris saved the city about €35 million with the shift to public ownership, leading to a reduction of water tariffs by 8% compared to 2009. The integration of fragmented parts of the water system gave birth to a more efficient, consistent and sustainable organisation, as well as revived water resource protection, research and innovation, and awareness-raising activities. Of course, results will need to be assessed over the long run, but the debut is promising.

## Two water giants and an old network under tension

Paris is a densely populated city of 2.2 million inhabitants and the larger metropolitan area comprises approximately 10 million people. It is also home to the biggest water corporations in the world, *Veolia Environnement* and *Suez Environnement*. These companies were established (under different names) in the second half of the 19th century, under Emperor Napoleon III, but contrary to most other Western countries who municipalised their urban water systems at the beginning of the 20th century, these two firms managed to retain most of their contracts in France. Even as managers of vital natural monopolies, they were not affected by the country's three waves of nationalisations (1936, 1945 and 1981). This is an indication of the political power they could yield thanks to strong connections extending throughout the political system.<sup>1</sup>

What is unique about Paris' water is that it runs through two networks. The current drinking water and wastewater systems were created in the 1860s and completed in the early 20th century thanks to massive public investments into a state-of-the-art network of sewers and pipes. The latest phase in the development of the water network was part of an effort to stop the cholera and typhoid fever epidemics caused by the consumption of untreated water from the older network constructed under Napoleon I. Both networks are still in use today: the former supplies about 550,000 m<sup>3</sup> of drinking water a day to its inhabitants, half of which comes from groundwater and springs located in a large belt around the city and half from the rivers Seine and Marne, whereas the non-drinking water network is used for watering the parks and cleaning the streets and sewers.

Another distinctive feature of the Paris water systems is that very few residents are aware of their water tariffs because there is limited individual billing, water typically being included in buildings' collective charges. Nevertheless, decreasing consumption,<sup>2</sup> rising standards for wastewater treatment and additional taxes have translated into massive hikes in water charges over the past two decades. Rising pollution levels coming from industry and household effluents as well as industrial and chemically intensive agriculture (mostly cereals in this region) threaten the sustainability of the resource.

### **Privatisation of supply, corporatisation of production**

Until 1984, Paris' water systems were entirely run by the city with one notable exception: billing, which had been outsourced to Veolia (then called *Compagnie Générale des Eaux*) in 1860 and grew to become a very lucrative business that generated a 60% profit rate over the 30 first years.<sup>3</sup> The network's efficiency varied through the years however: it was in a dire state after World War II (44% losses), then improved until 1966 (22% losses), and degraded again until 1976 (32% losses). After the city elected its administration in 1977 in the first municipal election in over a century, the trend was reversed, with the network's efficiency improving again to reach an average of 20% losses between 1980 and 1984.<sup>4</sup> The raw water network was hardly maintained throughout this post-war period.<sup>5</sup>

In 1984, then-mayor Jacques Chirac signed a 25-year contract to subsidiaries of Veolia and Suez (its CEO at the time, Jérôme Monod, was a co-founder of Chirac's party) to manage Paris' water supply and billing services. Maintaining the non-drinking water network was also part of the contract. Veolia was awarded the right bank of the Seine River and Suez, the left bank; this two-thirds to one-third customer sharing agreement interestingly reflected the companies' respective market weights in France. They also established a special joint unit called *Groupeement d'intérêt économique* (GIE) to collect invoices based on Veolia's historic database of clients.

In 1987, the water production and the control mechanism for the two private companies in charge of supply were also partially privatised with the creation of a mixed capital company, SAGEP (*Société Anonyme de Gestion des Eaux de Paris*). An outsourcing contract was signed between Paris and SAGEP, whose capital was owned 70% by the city, 28% by Veolia and Suez (each owning 14%), and 2% by the *Caisse des Dépôts et Consignations* (CDC), a public national investment bank. The private companies' shares in SAGEP placed them in a clear conflict of interest since the latter was supposed to oversee the concession, a situation said in a 2003 city audit to create "a paradoxical role, and partnership relationships that are not favourable to a controlling exercise."<sup>6</sup> A first step toward privatisation was also taken with the city's internal Water Quality Control Service becoming an independent public body, the *Centre de Recherche et de Contrôle des Eaux de Paris* (CRECEP).

Under this new institutional setup, the network's leaks were reduced from 22% of the water serviced in 1985 to 17% in 2003, and after a harsh renegotiation of the contract between the city and the operators (see below), this figure was reduced dramatically to 3.5% in 2009. But water tariffs increased massively, by more than 265% between 1985 and 2009 for drinking water alone, with automatic tariff updates every three months; in contrast, inflation only rose by 70.5% over the same period. Such an increase led to strong suspicions of excessively high rates of profit for the two companies. For instance, water tariffs in Paris increased by more than 90% between 1991 and 1997 whereas they only increased by 51.5% in other French cities of more than 100,000 inhabitants over the same period.<sup>7</sup>

The city also began to lose control over the system's technical knowledge: no patrimonial assessment of the supply network had been performed before the privatisation and authorities became entirely dependent on the private companies to obtain information on the network's state. The city's administration also had difficulty accessing reliable financial information: a 2001 audit by the city showed that the bill collecting entity, GIE, had never been controlled, and concluded that "the satisfactory service does not justify such a high cost."<sup>8</sup> Another audit by the Region's Court of Auditors showed that GIE never declared to the city the extra revenue it obtained. Last but not least, another 2001 audit of Veolia's Paris subsidiary showed that it was "a very profitable company" and a "generous cash-flow contributor to the group."<sup>9</sup> The official average annual profit made by the two companies was about 6-7%, but sources at Eau de Paris today argue that in reality it was closer to 15%, although this is impossible to prove given the absence of reliable data. In addition, many works undertaken by the companies were commissioned to their own subsidiaries, a classic way to extract additional profits through overpricing; but here again, the exact level of profits remains unknown except to the companies' top

executives. As far as the maintenance of the raw water network was concerned, it was hardly done at all: the companies had no economic incentive to take this on, the contract hardly required any maintenance anyway, and the controller SAGEP was not unfavourable to the dismantlement of the network, hoping to sell extra drinking water that would compensate the consumption decrease.<sup>10</sup>

## **Toward remunicipalisation**

In 2001, newly elected Paris Socialist Mayor Bertrand Delanoë published a communiqué on the need to take control of the city's water services.<sup>11</sup> Concrete steps were quickly taken by the city to regain control of certain in-house competencies and capacities. For instance, a team was established to follow up and control water infrastructure construction projects, a consultative commission was created to involve users in water policy, and a separate 'water' section in the city's budget was re-established.

### *2001-2003: Initial negotiations*

The new team heading the city soon realised that its capacity to control the service provided by the private companies was severely limited, and that financial opacity was "absolute," in the words of Anne Le Strat, then newly elected Green party politician appointed CEO of SAGEP. Within the city's administration, Le Strat quickly became renowned for her strong commitment to water remunicipalisation in Paris. For her part, Myriam Constantin, a Socialist, became Vice Mayor for Water and Sanitation. She took a less radical stance, stating that "what matters is that public authorities can develop genuine control over the services executed in their name,"<sup>12</sup> in line with her party's stance on the issue (many privatised drinking water systems in France are run by Socialist and even Communist municipal administrations).

Negotiations to review the contract started almost immediately between the city and the private companies. They involved only a handful of city managers and were kept secret from the public and from most elected officials. Only their outcome was made public in 2003: the companies agreed to lower their declared average profitability rate from 6-7% to about 4%, to invest €153 million by 2009 to accelerate the network's renewal, and to replace lead joints to comply with EU standards. But the water tariffs were not lowered, and the excessive amounts provisioned by the companies for construction works were only partially taken back.<sup>13</sup> The 2003 appendices to the contract signed with the companies cancelled the 1997 appendix, but the report explaining the details of the deal was partially censored by the municipality when published. Furthermore, 80% of the investments were financed by no-interest public loans, a good deal for the companies who had all these works executed (and likely overpriced) by their own subsidiaries.

Why such a favourable deal, and such secrecy, after years of public criticism of these two companies by Paris' left-wing politicians? The Socialists were constrained by the previous agreements made between the companies and former mayors, notably the 1997 contract that guaranteed a minimum profit rate to the operators to compensate for the decrease in volumes sold. They were also trapped by a loophole in the contract that enabled Veolia and Suez to wait between six and 10 months before transferring the money they collected to SAGEP, thereby generating substantial extra profits in interest earned over the period. In a nutshell, the reason Paris' Socialists were so discreet about the renegotiation was that the companies had not broken any provisions of their contracts, and admission of excessive charges would have required the city to reimburse Parisians! One must also take into account the water companies' numerous channels of influence within the city administration and among politicians: for instance, the vice-mayor at the time, Socialist Anne Hidalgo, had worked for Veolia between 1995 and 1997.

### *2003-2007: Building capacity*

The period 2001-2003 had been a reality check for Paris' new political leadership, revealing the narrow margins for manoeuvre associated with a privatisation contract with such powerful companies. To strengthen their position, politicians launched a series of legal, technical and financial audits as well as extensive consultations with Eau de Paris personnel to assess the potential consequences of cancelling the contract. The investigation concluded it was best to wait until the end of the contract in December 2009 for legal and technical reasons. Another finding made clear that issuing another PPP contract would be much easier to handle for the city's administration. As François Leblanc, director at SAGEP during the transition, put it,

the private to public transition had never been experienced at this scale... I think it was easier, technically and legally, to re-issue a new tender than to remunicipalise... It is not only the network management, it's everything; for instance, the assets are enormous, you have numerous buildings, plots of land, etcetera, that need to have their status changed; you have changes of taxation regimes... And all this work you have to do on top of all the rest.<sup>14</sup>

Nevertheless, these challenges did not deter the municipal team from staying the course with their agenda. The team made its first major move to remunicipalise in March 2007 by ousting Veolia and Suez from SAGEP through a city council vote that forced the companies to sell their shares – at a good profit<sup>15</sup> – to the French national investment bank CDC (Veolia's biggest shareholder at the time). GIE, the opaque financial structure set up by the companies to collect their invoices, was dissolved and the task of monitoring the two private companies was transferred back from SAGEP to the city administration. The private companies were worried but anticipated that they could still renew their contracts in 2009.

The real game changer event occurred on November 5, 2007: Delanoë, campaigning for his second term as Paris mayor, promised that water supply and billing, a €180 million annual contract at the time, would be publicly managed again if he were re-elected. According to most interviewees for this research, this decision was taken in a very small circle, and perhaps even on a personal basis since it took some of his closest colleagues by surprise when it was announced. Reasons behind this decision are multiple. One argument is financial and technical: the numerous audits and studies commissioned by the city and SAGEP indicated that substantial savings could be achieved by taking the service back in-house, and that a unified institutional setup made more sense than the ongoing fragmentation of responsibilities. This became the city's main official argument: public water management can be more efficient, and it enables the city to manage water as a common good rather than being treated as a private commodity. But one must also point out that Delanoë was, at the time, tempted to play a bigger role in national politics, and ran for the position of first secretary of the Socialist Party later in 2008 – which he eventually lost. His decision to remunicipalise water could therefore be interpreted as a political signal sent to the party's left wing to change his image as too business-friendly. Veolia and Suez argue that it was a political decision, rather than one made on financial or technical grounds. In any event, Delanoë was re-elected mayor of Paris very comfortably on March 16, 2008 with 57.7% of votes for his coalition.

### *2008-2009: Decision time*

In July, 2008, the city took another step toward remunicipalisation by buying CDC's 30% share in SAGEP, which then became a fully municipal company. But an even more critical decision came on November 24-25, 2008, when the Paris City Council voted for the entire water system, from resource protection to end user, to be operated by one unified public entity beginning January 1, 2010. This served as the first official announcement of the remunicipalisation and initiated a complex legal process that had taken months to design and plan: SAGEP was liquidated before the end of its contract but not dissolved thanks to a universal assets donation that enabled the creation of the public company Eau de Paris on January 1, 2009, before the contract with Veolia and Suez ended.

The private operators who thought the mayor's pledge was nothing more than an electoral promise were furious, and complained that his decision would ruin their public image and undermine their global commercial position. They quickly toned down their criticism, however, taking the stance that this was a purely political and ideological move that had nothing to do with their performance. Meanwhile, two members of the right-wing opposition – UMP city councillors Jérôme Dubus and Jean-François Legaret – challenged the municipal decision in court in January 2009. They claimed that this move

was in breach of European treaties, which required all public authorities to organise a tender each time they wanted to entrust the execution of an economic activity to an operator engaged in the market. The court dismissed their accusation, ruling in May 2010 that under EU regulations a municipality had the right to manage any service to its population in-house.<sup>16</sup> There was thus no legal obstacle to the transfer, and the final decision to launch Eau de Paris, formally voted by the City Council in November 2009, was confirmed.

## From fragmentation to unity

As soon as the official remunicipalisation decision was taken, a task force was created to organise the transition. It was an enormous challenge given the short 18 months left before the actual transfer, with major bottlenecks to overcome.

### *IT systems: Blurred property boundaries*

Generally speaking, the private operators cooperated throughout the transition, but some aspects proved more difficult to deal with such as the transfer of the customer databases and information systems. In fact, customer relations (metering, billing, follow-up and interventions management) remain outsourced to the private operators until 2012 to ease the transition. Customers and technical data was transferred, as it was a legal requirement, but the transfer of the IT tools developed by the private companies to process and articulate the various sets of data has proven to be a much more sensitive issue. Technical and geographical information systems were rather simple to integrate with the former SAGEP system, but transferring the IT tools making the strategic link with the commercial systems was much more difficult because such tools are important factors for these companies' competitiveness.

To add to the complexity, the existing IT systems were not compatible: the two companies have different histories, are more or less centralised, and the systems are proprietary. "We don't manage to speak to the relevant specialist, it's just as simple as that,"<sup>17</sup> complains a current manager at Eau de Paris in charge of the dossier. As a consequence, one of the first steps of remunicipalisation was to identify what, within these centralised systems, belonged to the Paris contract. The companies apparently only began to collaborate when they were sure that they would get a service contract for this work, and that the allocation of tasks and liabilities was clearly laid out. Trust was a major issue in these tense negotiations, each party imagining worst case scenarios.

In the end, the collaboration was fruitful and Eau de Paris developed its own information system, based on one put in place by the French city of Grenoble when it remunicipalised its water services in 2000. The unified information system was launched in October

2011. Eau de Paris also recruited external know-how in order to create a commercial department that now employs managers coming from electricity and telecom companies notably, bringing with them new methods and approaches.

*Workers: From five organisations to one*

One of the most delicate parts of the transition concerned workers: 642 workers from Eau de Paris, 228 workers from Veolia and Suez, 55 workers from CRECEP, and 14 workers from the city administration were to be brought together in the same company, involving 15 different unions in a six-month negotiation over wages, working conditions and benefits. The negotiations were completed just in time and produced a partial agreement signed in December 2009. All workers integrating Eau de Paris were paid according to a harmonised salary scale in January 2010.

However, this achievement conceals some ongoing difficulties. One problem was with the type of workers who were transferred from the private operators: all workers coming from the private sector were given the choice to stay with the company or go to Eau de Paris, and both private operators managed to keep the overwhelming majority of their higher ranking staff: no managers were transferred from Suez, and very few from Veolia. Eau de Paris tried to recruit a few managers from the private companies, but its incentives seemed no match for the private companies' and it had to recruit external personnel for management positions, a lengthy and sensitive process. In general, the re-organisation of the whole structure was very demanding and created a host of tensions in the organisation, since many workers had to substantially change their assignments.

A second difficulty was more pernicious: the two unions coming from Suez and Veolia and the one from Eau de Paris did not merge, despite belonging to the same union federation (CGT), and Veolia employees could not preserve all their previous benefits but are still fighting to access them.<sup>18</sup> This situation gave rise to a legal battle between the two unions, each accusing the other of betraying workers either by being too close to Eau de Paris' directors<sup>19</sup> or by acting on behalf of Veolia and Suez<sup>20</sup> to undermine remunicipalisation. This in-fighting has continued, with the added tension of some outsourcing of service contracts having ended in July 2011 and some unions threatening to sue Eau de Paris for not automatically hiring workers from these outsourced firms.

*Financial management*

The biggest problems, however, were experienced with the financial system, particularly the transition from private to public accounting and buying procedures. As a public company, Eau de Paris requires all procurements above a certain price threshold to be decided by a commission, whose recommendations are then decided by the board. As a result,



delays have occurred in some important areas and administrative processes have generally grown more burdensome. Furthermore, public entities in France are legally required to establish a budget based on particular accounting methods. Finally, all payments are done by one sole public official, an accountancy agent (*agent comptable*) detached to Eau de Paris from the Ministry of Finances but who remains legally separate from the public operator and who is personally responsible for everything he signs.

Specific IT tools also had to be acquired to manage the thousands of invoices, creating another hurdle because the market for accounting software dedicated to managing public industrial structures in France is almost non-existent after three decades of privatisations. All this translated into severe, sometimes dramatic payment delays to suppliers. The situation is now improving, with several consultants hired to clean the books by the end of 2011, and with payment delays having been brought back to an above-average 30-35 days. The buying and procurement procedures are clearly heavier in the new institutional setting as compared to what existed before, but expense control has greatly improved.

#### *Ideological and structural obstacles within the city administration*

One last difficulty is that some departments within the city administration, particularly the water and finance departments, were opposed to the remunicipalisation and thought that the mayor's pledge was nothing more than a political gesture that would not materialise. The consequence was that the transition was neither anticipated nor prepared for by these departments. Another explanation for this situation is that many public officials in management positions seem to prefer outsourcing public services to the private sector because it enables them to avoid managing complex infrastructures and numerous personnel. It can be simpler to organise a tender and, if necessary, to hire a consultant to solve the legal difficulties and/or monitor performance.

### **Achievements, challenges and perspectives for Paris waters**

Despite important challenges, Eau de Paris began operating Paris' water systems on January 1, 2010, and there was no apparent difference in service to end users. But of course lots had changed, including the signing of a performance contract<sup>21</sup> between the city and Eau de Paris, defining the new public company's objectives, putting it under closer scrutiny than any local water provider in the past in an effort to demonstrate that the public sector can be operated in a transparent and efficient manner. The contract was reviewed and approved by the municipality with indicators that enable the City Council to monitor performance and to communicate to workers and the wider public what the political objectives of the new water systems are, including permanent access to the best possible

water at a fair price, better transparency of water management with a clearer allocation of responsibilities, increased participation of users in the systems' management and strong social and environmental responsibility ambitions.

Eau de Paris is now a *régie à personnalité morale et à autonomie financière*, a semi-autonomous body with a separate budget and legal status. It is publicly owned and city-controlled. All top management appointments are decided by the City Council. The board is the highest body in the organisation and includes a president (currently Anne Le Strat, re-elected in 2008 and now also vice-mayor for water, sanitation and canals), 10 members of the City Council, two staff representatives and five 'qualified' persons including two water and sanitation experts, one environmental NGO, one consumer organisation and one member from *Observatoire Municipal de l'Eau* (City Water Observatory).

With Paris managing its water systems in-house, expectations were high at home and abroad and the move was monitored attentively by many in the water sector. After only 18 months of public operation (at the time of writing) it is still too early to offer a definitive assessment, but a number of key achievements and lessons can be highlighted, as outlined below.

#### *Financial savings above expectations*

An outstanding achievement, beyond the sheer fact of having managed such a challenging transition in such a short time, are the economic results of the remunicipalisation. Operating costs are below expectations and below those of the private companies, while transition costs were lower than planned. The transition itself cost Eau de Paris roughly 15% of its turnover in its first year, but since financial surpluses reached €68 million (a figure that must be balanced out by the fact that some capital investments were postponed). Overall Eau de Paris saved some €35 million on its previous contract costs with Suez and Veolia thanks to remunicipalisation. These savings come from the internalisation of profits previously extracted by the private companies to pay shareholder dividends, from the systematic organisation of competitive tenders for works that were previously entrusted to the companies' subsidiaries, and from a more beneficial tax regime for in-house rather than private companies. These savings are expected to last, and enabled Delanoë and Le Strat to announce on January 5, 2011, an 8% decrease in Paris' drinking water tariffs (from €1.0464/m<sup>3</sup> to €0.9627/m<sup>3</sup>), a symbolic victory that infuriated many in the private water industry who have been pushing for hikes in water tariffs for years. The city promised Parisians that the water tariff would not increase above inflation until 2015 (year of the next municipal election) despite decreasing revenues associated with diminishing consumption volumes of residents.<sup>22</sup>

*Better planning for the long term*

Another achievement is the creation of synergies by merging the three previous operators into one for the same service area, enabling scale savings, a clearer institutional structure with cross-checks between water production and supply departments and a centralised overview of the cycle. In terms of water quality there is no detectable difference with the private sector era, but this new institutional architecture enables more comprehensive quality control. The researchers of the former public laboratory of the city (CRECEP), which was closed by a national government decision to open the “market” of water quality testing to competition, were partly re-hired in Eau de Paris’ new internal laboratory. Importantly, a public water research centre called *Aqua Futura* has been launched with funding from the city, the region, and partnerships with neighbouring universities, and aims to create a centre of excellence for public water, independent of the large groups that dominate water research in France.

One must also note Eau de Paris’ renewed interest in protecting water resources and tackling water pollution challenges over the long term, such as establishing partnerships with farmers around water catchment areas to help them switch to organic agriculture or at least to practice agricultural methods requiring fewer chemicals (the groundwater that supplies 50% of Paris’ water did not need treatment until the 1990s). The program is new and will take several years to deliver, but several farmers have already begun the transition toward more environment-friendly farming with the support of Eau de Paris.

Network performance remains strong for drinking water (due in part to the high level of maintenance by the private companies in the last few years of their contract, a result of the 2003 contract renegotiation) but the network’s age is a worrying factor. There is a major difference between maintaining a network, which the private companies did, and renewing it, which was not done according to Eau de Paris managers. Big investments are needed and have already been planned, but the question remains: How long can this old infrastructure last? Some engineering knowledge has been lost in the transition from private to public ownership and needs to be re-built. A total assessment of infrastructure health, which had never been done, is now being undertaken by the city.

The fate of the network transporting raw water is more uncertain. Abandoned for decades, it requires major investments to be rehabilitated, but its dismantling would be extremely costly. The city has now launched a public debate to determine what infrastructure needs should be given priority. Either way, the cost of this prolonged inaction will be high.

*Reaching out: Transparency, solidarity, participation*

Eau de Paris is investing in its general communication and in new interactive tools to enable users to better monitor their own consumption of water, the quality of water in their street and neighbourhood, and the planned works that might disrupt traffic. This transparency effort has been recognised by the main French consumers' association, *UFC Que Choisir*.<sup>23</sup> Eau de Paris' new website features numerous resources on the history of the service, its environmental impacts, and its social and solidarity programs. Eau de Paris has also launched campaigns to promote tap water against bottled water, to give advice on water savings and, more generally, to raise awareness about water challenges in Paris and worldwide.

The new public water company is also engaged in solidarity actions: it increased its contribution to the city's housing solidarity fund (from €175,000 to €500,000), paid a water solidarity allocation to 44,000 poor households in the city, commissioned a report on progressive billing,<sup>24</sup> launched a water saving campaign, and has systematically avoided cutting off water supply in squats. But solidarity is not restricted to local water users, with Eau de Paris engaged in defending and promoting public water management at the European and international levels. The public provider co-founded *Aqua Publica Europea*, a European federation of public water operators that represents and promotes public water management at the EU level, as well as defends public operators against water corporate lobbying activities. It supports NGOs of African migrants willing to develop water supply and sanitation in their home countries, and has established a partnership with the Moroccan *Office National de l'Eau Potable* (ONEP) to develop water supply in Mauritania. It also financially supports other public operators in developing countries, such as Phnom Penh,<sup>25</sup> one of the most efficient public operators in South-East Asia,<sup>26</sup> where Eau de Paris funds social connections.

In terms of user participation in the new public system, outcomes have been mixed. The push to remunicipalise was not driven by civil society, but city politicians have attempted to broaden the system's governance and involve users in decision-making processes. The City Water Observatory – a civil society water assembly created in 2006 to bring together consumers (mostly property agents), environmental NGOs, institutional players, and water experts that now meet six times a year – plays a consultative role at the moment, although Eau de Paris has been considering granting it a voting right on the board. Eau de Paris has also commissioned a study on water user participation in the hope of identifying inspirational practices, but evidence suggests that there is little demand for this in Paris at the moment. According to Eau de Paris' communications department, individual users are interested in a municipal water management topic when the information is

brought to their attention but they rarely see their water invoice because of Paris' collective billing system and as a result awareness of local water issues has remained low, despite the dramatic change in ownership and operation.

On a related note, many Eau de Paris employees seem unconvinced about the remunicipalisation idea: in addition to union in-fighting, the decision to lower water tariffs generated unease among some staff that fear that revenue reduction might impact their working conditions or salaries. The development of a lively public service culture within the organisation, after all the difficulties created by the transition, will of course take time but remains a crucial task for the sustainability of the organisation.

## Conclusion

A striking fact about the remunicipalisation of Paris waters is that it has been a highly political move undertaken with little public pressure or participation. Some civil society groups pushed for the system to be taken in-house, but they never managed to attract media attention, and in any case their lobbying power was no match for Veolia's and Suez's. Although the Greens and the Communists pushed for remunicipalisation from an early stage, the Socialist Party remained divided on the issue. What probably made the difference in convincing Mayor Delanoë were the numerous and detailed audits proving the potential for financial savings, more than arguments about managing water as a 'public good'.

The transition was difficult, particularly on the financial management side and in terms of personnel. Certain competences had to be re-built and in-depth knowledge of the infrastructure will take time to regain. The private operators did not undermine the transition, but neither did they provide help beyond their legal duties, at times withholding information on commercial grounds. The fact that some sections of the city administration were reluctant to remunicipalise did not help either. There were also weaknesses in the reform process: it was very top-down, linked to a handful of committed and competent individuals, and it created tensions in the organisation.

But despite these challenges, the transition was managed on time and with very impressive financial outcomes. The integration of the fragmented parts of the drinking system gave birth to a more efficient, consistent and longer-term planning organisation, as well as renewed activity of the company into water resource protection, research, innovation, and awareness-raising. In general, the major bottlenecks experienced during the transition phase were tackled efficiently, with the exception of the bitter fight between unions. Overall, the preliminary assessment is promising, with Paris' water systems moving from opaque, fragmented and short-term management to a more integrated, transparent, longer-term and progressive approach.

Regardless of one's take on the outcomes, this enormous institutional reorganisation has created the institutional equivalent of a tsunami in a water sector dominated by privatisation ideology for the past three decades. The simplistic idea that the private sector is naturally better equipped to manage urban water systems was proven wrong in Paris, where a private duopoly by powerful companies was operating at the expense of the residents of the city. But this example has also shown that what has been done by politics can be undone by politics. There is no safeguard against the re-privatisation of Eau de Paris in the future. However, achieving the best performance possible and involving as many Parisians as possible in this success are ways for the city to work against a possible reversal. Political change brought about mostly by reasons of financial efficiency will then lead to a deeper set of political reasons to keep and broaden the public character of the city's waters.

## Endnotes

- 1 The French reform of political party funding in the 1990s forced publication of all party accounts, which triggered numerous corruption scandals. It showed that water companies had been for years among the biggest contributors to governmental and opposition parties alike. See for instance Guinel, J. (1994) De grandes entreprises en cause: l'eau éclabousse la classe politique française. *L'économiste* 157 (December).
- 2 Barraqué, B. and Nercessian, A. (2008) *Mieux comprendre comment évolue la consommation d'eau à Paris*. Paris: Agence de l'Eau Seine-Normandie, Mairie de Paris.
- 3 Stefanovitch, Y. (2005) *L'empire de l'eau*. Paris: Ramsay, p. 93.
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- 8 Ville de Paris (2003) *Gestion du service commercial des Eaux de Paris*. Fascicule 0: Synthèse et conclusions, October. Paris : Ville de Paris, p. 23.
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- 10 Mairie de Paris, Inspection Générale (2003), *op.cit.*, pp. 70-74.

- 11 Delanoë, B. (2001) *Pour une gestion citoyenne et durable de l'eau à Paris*. Communication de M. le Maire de Paris 37-2001, DPE 147, 19 November. Paris: Mairie de Paris.
- 12 Author translation of text quoted in Laimé (2007), *op.cit.*
- 13 Stefanovitch (2005), *op.cit.*
- 14 François Leblanc, former director at SAGEP and current managing director at Eau de Paris, author interview and translation, September 2010.
- 15 *Global Water Intelligence* (2007) Suez and Veolia exiled by Eau de Paris, April.
- 16 Tribunal Administratif de Paris, n°0901127/6-1, 2009.
- 17 François Leblanc, author interview and translation, September 2010.
- 18 CGT Veolia (2010) *Communiqué de presse sur Epic Eau de Paris, les ratés sociaux de la municipalisation Delanoë*, 8 January.
- 19 See interview with former CRECEP director Claude Danglot in *Contretemps* (2011) L'eau comme bien commun ? Un retour sur l'expérience parisienne de remunicipalisation. <http://www.contretemps.eu/interviews/leau-comme-bien-commun-retour-sur-l'exp%C3%A9rience-parisienne-remunicipalisation> (accessed 12 December 2011).
- 20 Such accusations have been repeatedly stated by a former Veolia unionist turned into a fierce public critic of the company, Jean-Luc Touly.
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- 22 Consumption decreased annually by 1.17% in 2008 and 1.9% in 2009, an overall 25% drop in consumption from 1990 (historical consumption peak).
- 23 Coing, H. (2011) *Baisse du prix de l'eau à Paris*. UFC Que Choisir? <http://ufc-quechoisir-paris-nord-est.org/l-eau-a-paris.php> (accessed 12 December 2011).
- 24 Barraqué, B. (2009) Abonnements individuels à l'eau en appartements à Paris: éclairages international et national. *Flux* (76/77): 82-93.
- 25 Solidarity partnerships between SAGEP/Eau de Paris and the Phnom Penh Water Supply Authority started in 2003.
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**Chapter Three**

From Fiasco to DAWASCO:  
Remunicipalising Water Systems  
in Dar es Salaam, Tanzania

by Martin Pigeon





Dar es Salaam's water and sewerage systems were in a terrible state when the government of Tanzania privatised them in 2003, signing a contract with City Water Services (CWS) – a joint-venture of Biwater (UK) and Gauff (Germany). This private consortium was later joined by a Tanzanian private firm, Superdoll. But private management did nothing to improve the situation, with the World Bank describing the private operator's performance as worse than its predecessor's. In 2005, a new public operator took over: Dar es Salaam Water and Sewerage Corporation (DAWASCO).

Since that time DAWASCO has managed to extend coverage and improve critical aspects of water service delivery in Dar es Salaam, proving that public water services can be managed well by the state, and can outperform the private sector in many ways. Nevertheless, overall results are mixed, as DAWASCO has also begun to operate increasingly like a private company, focusing on full cost recovery and failing to meet its obligations in the lowest income areas of the city. To be fair, the daunting challenges faced by DAWASCO since remunicipalisation are part of the problem: derelict infrastructure, unreliable customer data, degraded water resources, and strict but not necessarily relevant conditionalities imposed by international donors to access investment funds. Understanding these challenges requires a review of the general legacies of post-colonial Tanzania, as well as the impacts of the failed privatisation. It also requires an examination of the ideological assumptions that continue to inform policy and practice in Tanzania as a whole.

## Historical background

Following its 1963 independence from Great Britain, and its 1964 partial merger with Zanzibar, Tanganyika became Tanzania, ruled by charismatic figure Julius Nyerere and his Revolutionary Party (*Chama cha Mapinduzi*, CCM). The first 25 years of independence were marked by an original socialist-inspired political regime that sought ideological independence from both capitalism and Soviet-style Marxism through 'African socialism' (*Ujamaa*), which was inspired by egalitarianism, self-reliance and cooperative agriculture. Most banks and industries were nationalised, literacy rates and access to health care and water supply were considerably improved, the state was successful at preventing ethnic clashes, and party leaders were legally kept from accumulating wealth and power.<sup>1</sup> The government, however, faced harsh difficulties. The collectivisation of agriculture was a disaster: production plummeted causing heavy reliance on food imports, and millions of resettled farmers went back to subsistence farming. The economic crisis of the late 1970s combined with the 1979 military intervention to oust Uganda's Idi Amin Dada had a severe impact on the national economy: by the early 1980s, industry was functioning at only 30% of its productive capacity.<sup>2</sup> The one-party system was also showing signs of exhaustion, with corruption spreading.<sup>3</sup> Nyerere stepped down voluntarily in

1985, leaving Tanzania among the poorest and most aid-dependent African countries.<sup>4</sup> Many Tanzanians still remember this mixed experience with centrally planned economies and large state bureaucracies. Since then, many social gains made in the 1970s such as literacy, public health care and water supply have been undermined.<sup>5</sup> The country had to comply with tough international financial institutions lending conditions leading to the privatisation of most of its parastatal companies<sup>6</sup> to access debt relief. We will see that this imposition played a key role in our case.

Dar es Salaam is the largest city in Tanzania, as well as its main industrial and commercial centre. The city has an official population of 2.5 million, projected to reach 3.5 million by 2015,<sup>7</sup> but unofficial estimates put the figures at 3 million in 1999 and a current population of up to 5 million, with a 7-10% yearly increase.<sup>8</sup> The city has a tropical climate with hot and humid weather most of the year, heavy rains falling between March and early May and between October and December to a lesser extent. This important rainfall seasonality is becoming more extreme with climate change and is reflected in more extreme river discharge variations, an important fact given that the city gets more than 90% of its water from rivers.

The water supplying Dar es Salaam comes from two main sources: the upper and lower plants on the Ruvu river (about 60 km north-west of the city) developed in 1959 and 1976; and an older small surface scheme in the southern part of the city completed under colonial rule in 1952. About 35 boreholes scattered throughout the city also supply the network, a legacy of those drilled in emergency during the severe droughts of 1984-1985 and 1997. The piped network was first developed in the city centre in the 1920s and 1930s, significant additions were made in the 1950s and the last major expansion occurred throughout the 1970s when the system's performance was at its best (most connected households were getting 24-hour supply at that time).

After independence, water supply in the city was directly managed by the Ministry of Water and Power. In 1977, the department in charge was turned into a parastatal company, the National Urban Water Authority (NUWA). Until 1991, those whose property was directly connected to the system had to pay for water while the water delivered at kiosks was free. A 1997 reform transformed NUWA into the Dar es Salaam Water and Sewerage Authority (DAWASA), a semi-independent entity aiming at financial autonomy, and combining for the first time both water supply and sanitation. But the last significant investments in the system dated back to the 1970s and had not been followed by proper maintenance, upgrades or expansions to cope with the city's rapidly increasing population. Thus, the system was in a terrible state by the early 1990s, with high levels of disrepair, unaccounted for water, major financial losses, demotivated workers and very low coverage.

This long-standing negligence also means that data related to water production, transfer, distribution and use in the city must be dealt with cautiously: metering has neither been consistent over time nor reliable, and the figures are politically sensitive, being crucial performance indicators for the utility managers and having played a pivotal role in the privatisation conflict. Data presented here must therefore be understood as an indication of scales and trends and not necessarily as an exact reflection of the state of water services in the city.

## The failure of privatisation

In August 2003, the World Bank spearheaded a US\$164.6 million fund to privatise Dar es Salaam's water services, under the banner of the Dar es Salaam Water Supply and Sanitation Project (DWSSP).<sup>9</sup> This initiative was welcomed with relief by local authorities as well as the media, as it signalled the launch of a much-awaited and badly-needed infrastructure investment program.<sup>10</sup> Assigning a lease contract to a private operator was a strict condition on the funding, and despite some progressive wording little consideration was given to public consultation, pro-poor focus or political debate.<sup>11</sup> The contract was kept secret even from Parliament. The experience did not last long: 21 months into the private concession, the government of Tanzania terminated the contract with the private water operator and police even briefly arrested its executives, who were soon expelled from the country.

In retrospect, the lead-up to the privatisation lasted much longer than the experiment itself. Already in 1997, the government of Tanzania consulted international private water companies about a concession contract but could not reach an agreement as none of the companies were willing to risk injecting money into a system that had been neglected for 20 years. There was also disagreement on the 'best' privatisation option. In the end, the World Bank insisted on redesigning a tender looking at a more limited investment from the private sector, and the government responded by proposing a 10-year "operating lease contract" in which a private company would take over responsibility for billing, tariff collection, general management and routine maintenance. In that scheme, DAWASA would retain ownership of the assets, rehabilitate and expand the network and monitor the performance of the operator. A first bid attracted proposals from three companies (Vivendi [now Veolia], Saur and Biwater) but was cancelled given the companies' proposed conditions. A revised bidding process ensued, but the two French companies, Vivendi and Saur, withdrew their bids before the financial application stage, apparently convinced their UK competitor would be chosen whatever they proposed.

When CWS won the contract, it was a newly created joint venture between Biwater and Gauff Tanzania. They later formed a consortium with Superdoll Trailer Manufacture

Company Ltd (STM), a Tanzanian investor with a minority shareholding of 49%. The consortium's risks were limited by a string of "sweetener" loans and construction contracts from the donors in order to get them to accept below full cost recovery water tariffs in the first five years of the lease (although STM did not benefit from these contracts). The initial concept of the lease contract was to put the capital risk on DAWASA and the operational risk on CWS, but these boundaries were blurred by the addition of construction contracts worth US\$40 million that were safer sources of profit for the European companies.

As soon as operations began problems accrued, to the point that CWS stopped paying its monthly lease fee to DAWASA in January 2004, only five months after the contract started. CWS injected only half the capital it should have (US\$8.5 million), and the company's revenue dropped by a third between August 2003 and March 2005. Billing efficiency collapsed, new customers sometimes did not enter the billing system, and existing customers seemed to benefit from increased leeway in making payments directly to the company's revenue collectors. Technical performance was no better, with large delays in implementing first-time connections and getting started on the construction contracts. On top of all this, a 2006 report by the Ministry of Water<sup>12</sup> found that no financial report had been provided by CWS to DAWASA during the contract period.

Several reports and interviews with employees, union representatives and senior managers point to three main explanations for the failure of CWS. First, there was a surprising ignorance of the terms of the lease contract among CWS top executives who seemed to assume key components of the contract were still negotiable. On the crucial issue of tariffs, for instance, CWS was refused two tariff increases because of its poor technical performance.

Second, employees and technicians were "poorly trained and equipped," "badly remunerated and inadequately supervised,"<sup>13</sup> a situation that translated into widespread corruption and revenue collection embezzlement by employees. In its one and only substantial organisational reform, CWS attempted to retrench almost 40% of the workforce when it decided to sub-contract parts of the lease contract, despite promises made to the unions not to downsize. However, the contract was terminated before CWS could proceed.

Third, CWS's main objective was to improve revenue collection through a better billing system and customer database. It introduced new software to do so, but its implementation was very slow and was never completed. It also prioritised the metering of the network but did not consider that most meters spin on both air and water, a serious problem in a network characterised by rationing and low pressure. Many new metered customers were billed for large quantities of air passing in the pipes.

Technical performance improvements were also held back by external factors such as poor data reliability (CWS believed DAWASA had inflated connection and supply figures), unresolved legal doubts on interpretation of the lease contract, and considerable delays in other aspects of DWSSP's implementation. The non-payment of the lease fee as well as withholding of promised capital by CWS increased tension in its relationship with DAWASA, undermining potential collaborative work. The situation worsened among shareholders as well because Biwater and Gauff were reaping the biggest procurement contracts while the local investor, STM, barely had a say in the consortium's decision making. It got to the point that STM tried to sell its shares and refused to provide the second half of its required capital investment, prompting other shareholders to do the same and deepening CWS's financial crisis.

Lastly, but importantly, CWS was operating even though the independent regulator EWURA was not yet in place. This meant that regulation and performance monitoring were done by DAWASA and the Ministry of Water even though they were party to the contract. Once the government of Tanzania secured the DWSSP loan, it had few incentives to help CWS beyond its contractual obligations – although it did so in the early phase by giving CWS extra time to make payments. The conflict between DAWASA and CWS escalated. An independent facilitator was appointed, immediately drawing up a list of key issues to be addressed, but the government announced the termination of the lease contract before the conciliation procedure was finalised. It seems it had gathered sufficient proof of CWS's failure to win ensuing litigations and make sure that funders would not stop paying. This is why some argue that the failure of CWS was politically convenient for the government, who could then put the general blame on the company for the city's water problems and show action to remedy the CWS crisis a few months before the presidential elections.<sup>14</sup>

Court cases between the government of Tanzania and Biwater-Gauff at the United Nations Commission on International Trade Law (UNCITRAL) and at the World Bank's International Centre for Settlement of Investment Disputes (ICSID) were not won by the company. Although the government of Tanzania was deemed guilty of illegally terminating the contract, it was not forced to offer any financial compensation. The UNCITRAL tribunal analysed the situation differently and sentenced CWS to a £3 million fine,<sup>15</sup> which was never paid because CWS had gone bankrupt, leaving the government furious at what it now describes as a "malicious deal."

## **Back to public**

Immediately following the termination of the contract with CWS in 2005, the government of Tanzania took control of the entire company structure – assets and employees –

and appointed a senior Ministry of Water and Irrigation official as CEO of the company renamed Dar es Salaam Water and Sewerage Corporation (DAWASCO). DAWASCO is a public parastatal company owned and financed by the Tanzanian state with a board appointed by the ministry. At creation, its most pressing tasks were to increase the systems' coverage, reliability and revenue.

### *Improving coverage and access*

Perhaps the most immediate challenge for DAWASCO was addressing the extremely high level of leaks and unaccounted for water in the systems, estimated to be as high as 76% of the water leaving the treatment plants.<sup>16</sup> The situation has improved since DAWASCO came into being, bringing the leaks rate down to roughly 56.5% in 2009, but this figure is still unacceptably high and recent donor-funded works on leakage reduction are hoped to make a more significant difference.<sup>17</sup>

Extending coverage is also a priority. Current estimates show that between 62% and 68% of city dwellers use tap water but only 8% have piped water in their homes. This figure nevertheless represents a 12.7% increase in connections between 2006 and 2009, with coverage continuing to increase according to interviews with DAWASCO officials. Connected users received an average eight hours of service a day in 2008, a figure that represents a slight improvement from 2006, but this has not progressed since.<sup>18</sup> Overall, however, DAWASCO has managed to improve coverage and is better positioned to meet rising demand for water in a growing city. DAWASCO also reports steady advances in metering, from 45% of connected users in 2006 to 67% in 2009. For billed customers, official water tariffs were increased in 30% in July 2006 to reach US\$0.46/m<sup>3</sup> and remained unchanged until August 2009 when they were raised again to US\$0.56/m<sup>3</sup> (a point we will return to). In terms of responsiveness to users, DAWASCO has made substantial efforts to improve its performance, open communication channels and monitor efficiency in handling complaints.

Daily water production capacity is roughly 273,000 m<sup>3</sup>, in addition to an average of 5,800 m<sup>3</sup> raw water from boreholes. This is still far below total water demand, which was evaluated at 450,000 m<sup>3</sup> a day in 2007. Moreover, production figures are a theoretical maxima: the volumes of water reaching the city's distribution network are in fact much lower, with some 43% of the water leaking or being illegally diverted (mainly for agriculture) along the transmission mains between the Ruvo River and the city reservoirs.<sup>19</sup> One must also account for the leaks within the city's distribution system, as noted above. All this means that the actual volume of water reaching city users is closer to 100,000 m<sup>3</sup> a day. As a consequence, storage capacity is hardly used and several neighbourhoods have scarce supply, or none.

The average income in the poorest areas of the city is roughly US\$30 a month, making the official cost of water expensive but not unaffordable for most households in the city. But given the systems' poor reliability and limited coverage, Dar es Salaam inhabitants must use other sources to complement or replace the conventional network, which is less convenient and more expensive, as follows:

- Thirty-eight per cent of households buy water from re-sellers who get water through their domestic connection and sell it to their neighbours, often at inflated prices.
- Some households use illegal connections or share private connections, creating further inefficiencies and reliability problems in the network.<sup>20</sup>
- Kiosks that are in part supplied by the network but are most often privately managed charge higher tariffs than the official EWURA rates.<sup>21</sup>
- Private boreholes service many affluent neighbourhoods.
- Private tankers serve to 'buffer' erratic supply.
- Many households use bottled water.

This de facto privatisation of substantial parts of the network generates high levels of inequality, with prices varying depending on the supply chain's length. Analysis suggests that the poorest city dwellers spend the largest share of their revenue and make the greatest physical effort to get water.<sup>22</sup>

Economic inequality goes hand in hand with the spatial inequality inherited from the city's past: the piped network was first built for European colonisers and was later extended to middle and high-income elite areas after independence. The development of the network has since been driven by specific economic interests (e.g. industries, hotels). The Lower Ruvu treatment plant (70% of the systems' production capacity) mostly serves connected users who are located in the affluent low areas (coastal zones), the city centre and some southern neighbourhoods. The remaining 30% of water comes from the Upper Ruvu plant, the Mtoni plant and operational boreholes, serving the poorer areas of the city (the industrialised southern zone and the upper and west zones).

### *Infrastructure funding*

In 1995, it was estimated that at least US\$600 million was needed to repair and extend Dar es Salaam's water network to match current and projected demand,<sup>23</sup> a figure that kept growing until DWSSP-funded construction works first started in 2003. More recently, the government pledged an additional US\$436 million over three years to further improve the city's water system. Considering that the 2010 Tanzanian state budget was US\$4.66 billion, with \$300 million earmarked for the Ministry of Water and Irrigation, the scale of the effort is massive.

The national government has been the primary source of infrastructure funding, mostly drawn from international donor monies. This is because although DAWASCO's revenue collection rose by 7.8% annually between 2007 and 2009, and by 24.3% annually between 2008 and 2010, it has not covered operational expenses and is far from covering the required capital expenditures. For instance, in 2009 DAWASCO collected roughly US\$10.5 million but faced operational expenses of US\$19 million. The goal remains to make sufficient revenue to cover both operational and capital expenditure, but it is clear that national government will continue to form the bulk of infrastructure funding for many years.

#### *Revenue and costs*

DAWASCO explains its difficulty in raising revenue by the fact that some public institutions are not paying their water bills (notably the army) and that, in general, many unsatisfied customers feel they should not pay for a poor quality service, they do not trust the metering, or simply cannot afford the service. Revenue collection has grown since DAWASCO started operations, but it has not kept pace with peak operational expenses, particularly those related to rising energy costs that make up as much as 25% of the utility's operational costs. Poor maintenance of the network and long distance transfers force DAWASCO to use considerable quantities of energy to pump the water into the city. Import of chemicals (e.g. algaefloc) also represents a substantial cost.

On the whole, the ratio of costs to revenue decreased steadily between 2006 and 2008,<sup>24</sup> suggesting progress in DAWASCO's organisational economic efficiency, but these efforts are cancelled out by surges in energy prices, with accumulated losses now amounting to more than 230% of DAWASCO's asset value. As a result, it is unrealistic to expect revenue generation within DAWASCO to address full operating and capital cost needs. Major central government investments will be an unavoidable necessity.

#### *Water quality*

Water quality at catchments along the Ruvu River continues to worsen, with higher turbidity every year as a consequence of more concentrated rainfall and environmental destruction in the river basin. Since completion of the construction works linked to the privatisation contract, the water produced at Ruvu plants has generally met World Health Organisation standards when leaving the plants and in the bulk water mains (with the exception of higher chlorine residues than permitted), but it degrades in the final sections of the city's network due to leaks and illegal connections, and is not safe for drinking without additional treatment. The sewer network's poor condition further adds to the problem by contaminating groundwater and at times the piped drinking water



supply. New investments in the endpoints of the network would be needed to solve this problem, but as yet investments have focused only on the production side.

### *Working conditions*

Staff working conditions are crucial to DAWASCO's performance. The CWS experiment was described by most interviewees as a major organisational disaster: leadership was largely perceived as illegitimate, low-ranking workers felt neglected, and the collective ethos of the organisation was badly damaged. This situation does not appear to have improved significantly since remunicipalisation: one third of employees were retrenched in 2007, following recommendations by business consultancy Ernst & Young, while new, young executives were hired and appointed in management positions, which caused resentment among older staff who felt they deserved these positions given their experience. Salary levels are also a problem as wages have been frozen since 2007 while inflation has been 10% annually on average.<sup>25</sup> Keeping competent staff on board is therefore a challenge and there have been numerous cases of engineers leaving the company after (expensive) training.

This inability, or unwillingness, of the organisation to offer adequate salaries and/or more motivating working conditions fuels another major problem: employee corruption. Indeed, most illegal connections appear to be performed by DAWASCO employees and many of those retrenched in 2007 are thought to be earning money this way today. Water bill embezzlement and excessive charging also continue to be reported.<sup>26</sup>

The implementation of individualised performance assessments is an attempt to increase employee oversight. The experiment began with area managers who saw part of their remuneration indexed on their fulfilment of performance indicators, including revenue collection. The scheme is now being extended to all DAWASCO employees, but with limited success considering that the paperwork it creates outweighs many of the possible benefits.

Tackling these issues is all the more difficult in an organisation whose top managers are typically engineers and tend to frame problems in technical terms, allegedly not favouring a flexible approach to human resources or good relations with non-specialist stakeholders.

### *Acknowledging outside help?*

In the early phase of remunicipalisation DAWASCO received considerable assistance from the public operator of Kampala's National Water and Sewerage Corporation (NWSC) in Uganda. NSWSC's External Services Unit was instrumental in advising DAWASCO on how to improve financial performance, leakage control and customer relations, notably

by helping designing the initial plans launched by DAWASCO's management. The first was the 100-day Operational Rescue Plan prepared in 2005 to reverse the poor performance trend. DAWASCO claims this plan led to a 36% increase in revenue collection and improved the number of metered connections and leakage control effectiveness.<sup>27</sup> It was followed by a "win-win" plan tackling the preceding issues on a longer term basis. Strangely, NWSC's role is now downplayed by many DAWASCO managers who point to the different hydrological and socio-economic contexts of the two cities.

## Looking ahead

### *Public ownership, corporate decision making*

In some ways, the only substantial differences between DAWASCO and its private predecessor CWS are the result of the transition to public ownership and top management replacement. The institutional architecture designed for the private operator remains largely in place, with DAWASA (the semi-independent public entity) owning the infrastructure and DAWASCO (the parastatal company) acting as the 'asset-light' company operating on the basis of a performance contract. In fact, the terms of reference of the contract between DAWASA and DAWASCO are almost identical to the one that existed between DAWASA and CWS.

This unusual institutional setup was created for two reasons: it was the easiest solution at hand in the short term to guarantee the operations' continuation; and the World Bank (and some officials at the Ministry of Water) wanted to keep the new operator under competitive pressure to be in line with their market-oriented way of thinking. The government also explored options for replacing the failed private contract with another one in 2005 and 2006, but no international water company was interested and so the status quo prevailed.

This led to an absurd and costly situation. Both DAWASCO and DAWASA are controlled by the Ministry of Water, but the former refused to recognise the latter's oversight authority and reported directly to the ministry. This mutual mistrust resulted in DAWASA having to pay an annual US\$120,000 (almost 1% of DAWASCO's yearly revenue) for the services of an external auditing company to monitor DAWASCO's performance because it refused to report directly. The unsatisfactory performance of the latter led DAWASA to impose significant financial sanctions (US\$50,000-100,000 per year), but these remained symbolic since DAWASA had agreed in December 2005 to wait five years before asking DAWASCO to pay the lease fee and associated performance-based bonuses or sanctions. The situation has begun to change with the appointment of a new CEO at DAWASCO, whose conciliatory approach has enabled a more collaborative

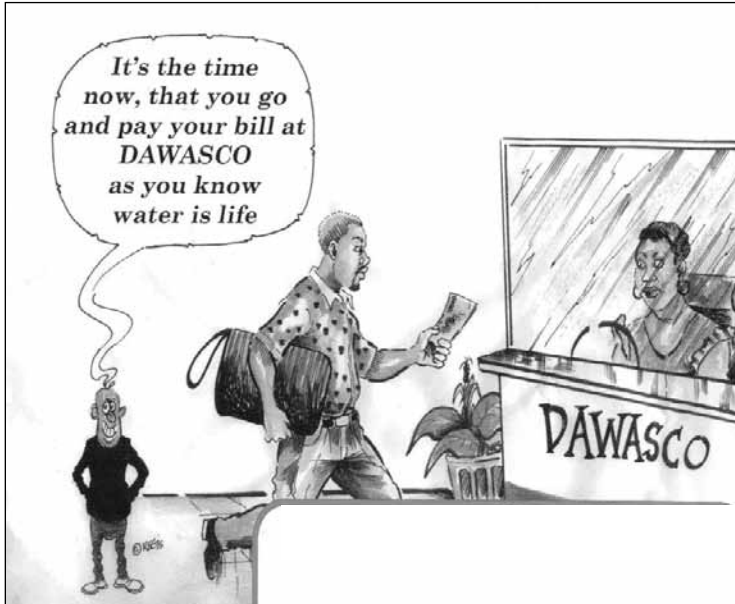
relationship, and their respective boards are now in regular contact. Although many managers in both entities now speak in favour of a merger between DAWASA and DAWASCO, the World Bank remains opposed to the idea and the option is not yet on the table at the ministry. Instead, the lease contract is still being renegotiated between the two parties.

#### *A commercial management culture*

This institutional setup of DAWASCO as an independent corporation also meant that its absolute priority was, and remains, that of increasing the revenue it receives from the water and sewerage services it provides. This translated into important efforts to clean customers' data, upgrade the billing system with the purchase of new and costly specialised software (US\$978,000) and diversify payment options (through mobiles phones, supermarkets, internet, etc). This modernisation drive is hindered by the low reliability of the whole system, irregular water supply and dubious metering, which all undermine the legitimacy of bills. The use of large-scale communication, media alerts and even scare tactics (e.g. temporary disconnections of entire neighbourhoods) to convince water users to pay for water managed to increase revenue by 37% between 2007-2008 and 2009-2010,<sup>28</sup> but DAWASCO also saw a surge in operational expenses over the same period. As a result, it has been piling up losses. The situation is now so dire that some senior managers at DAWASCO are considering opening up new businesses to generate revenue on the side for their company.

A striking fact emerging from interviews with most DAWASCO senior executives is indeed their desire to perform "as well as the private sector," a statement heard again and again, particularly when discussing DAWASCO's economic difficulties. This definition of 'performance' was also framed in private sector terms: financial efficiency and profitability were seen as preconditions to improvements in other service areas such as reliability, quality, safety and affordability. Whether this marketised attitude is a result of increasing neoliberal influence in the country, or the anti-public sector stigma associated with state bureaucracy of the past, or both, is difficult to say, but revenue obsession is also a product of the fact that the company's only legitimate revenue comes from water billing. The (crucial) financial contributions from central government and DAWASA that enable DAWASCO's operational survival are ad hoc and associated with a repeated and humiliating 'failure' message.

Another sign of the growing prevalence of a corporate culture is the systematic use of private business consultancies<sup>29</sup> to back major management decisions (layoffs, performance monitoring, etc) and the use of mainstream business management tools such as individualised performance assessments for employees.



Source: *Dawasco news*, Issue No. 2, July-September 2007

### *'Development partners' as decision-makers*

The water situation in Dar es Salaam is a recurring topic on the national political agenda, and it featured prominently in the 2010 presidential elections.<sup>30</sup> Re-elected President Jakaya Kikwete vowed to end the city's water problems in a major speech in July 2010 when he promised to expand water production capacity to 710 million litres a day by 2013-2014 with US funds from the Millennium Challenge Corporation (MCC) and to inject extra government money to develop the city's water treatment plants and exploit deep coastal aquifers south of the city.<sup>31</sup> But these promises are still very recent and history calls for caution in this regard: Kikwete made similar electoral pledges in his 2005 presidential campaign,<sup>32</sup> but the only large-scale public investment made was in a water transfer project from Lake Victoria to the Shinyanga region where there is a boom in gold mining.<sup>33</sup> Nonetheless, the government seems committed this time around and Parliament has supported a 15% increase in the Ministry of Water's budget for 2011,<sup>34</sup> as well as the launch of a US\$436 million program to upgrade Dar es Salaam's water infrastructure.<sup>35</sup>

But one must look beyond political rhetoric and go to the source of this funding. Monies come largely from development agencies and are attached to very specific conditions. International 'development partners' have controlled key decisions related to the

development of Dar es Salaam's water systems since the late 1990s. The US\$164 million DWSSP loan offered by the World Bank in 2003 that imposed privatisation only expired in November 2010 and is now being replaced by a US\$951 million Water Sector Support Project (WSSP) in which the Bank is teaming up with other international donors (MCC, African Development Bank, a German bank and the Netherlands' development agency, among others).<sup>36</sup>

This powerful, but locally unaccountable, political influence infuriates many water managers in DAWASCO, at least those who feel confident enough to speak openly about the problem. The general feeling is that international donors jump ship when there are problems but claim any success for themselves. Foreign water specialists are seen by many as self-interested and taking what they need from the country before leaving. A more specific reproach made to international financial institutions is that loans allow them to get the country under their thumb and force Tanzanians to develop as they are told. One DAWASCO executive summarised this rather bluntly: "If you want to get rid of them, you have to pay them their money back! But in the meantime they own you."<sup>37</sup> Another interviewee complained about having to lose time in meetings in which his only role was to sip coffee, munch biscuits, nod here and there and be used as proof that "the local stakeholders have participated in the project."<sup>38</sup>

Political and financial dependency undermines ownership and managers' commitment. A good example of this is found in the work program of a currently very active donor, the MCC. The MCC is a US foreign aid agency created in 2004 by former president George W. Bush. Its primary objective is to foster economic growth in developing countries through "good" economic policies.<sup>39</sup> Contributing a US\$207 million grant to the WSSP, the MCC funds two projects in Dar es Salaam: the expansion of the Lower Ruvu treatment plant and a non-revenue water reduction program. The expansion aims to increase the plant's capacity by 50%, up to 270,000 m<sup>3</sup> a day.<sup>40</sup> The problem is that the Ruvu river's dry season discharge is sometimes already too low to produce at full capacity, and the phenomenon has worsened over the past decades, climate change and deforestation factoring in. This means that the projected added capacity will be useless until completion of the construction of a large dam upstream (Kidunda) scheduled to start in 2011-2012 and last three years. However, this dam is already an old project that started with the Japanese cooperation agency that wanted to support its construction in the 1990s but backtracked after realising the potential socio-ecological damage and other shortcomings of the project.<sup>41</sup> The World Bank is now funding the initiative despite some water managers pointing at other possible and more sustainable sources. The government of Tanzania asked for a smaller dam downstream,<sup>42</sup> but works are underway and another reversal is unlikely.

Conditions to access MCC funding cause a second set of problems. Although the funds are a grant and not a loan, they come with a string of strict policy requirements. The 2008 compact states that “the water and sewerage authorities will be required to submit rate cases aimed at achieving operational and maintenance financial sustainability within the Compact Term and a sustainable trend for recovery of asset depreciation.”<sup>43</sup> One can read between the lines that this refers to full cost recovery. This is confirmed by the compact’s Monitoring and Evaluation Document, which mentions as a first risk for the project the inability of the government to implement “tariffs reforms falling short of recovery costs.”<sup>44</sup> Another source at DAWASA was more specific, talking about a full cost recovery objective for tariffs to be implemented by the last year of the project, that is, by 2013-2014.<sup>45</sup> With current tariff levels that are far below full cost recovery and new planned investments, this means that the water tariffs in Dar es Salaam are meant to increase by 250-300%.

The catch-22 is that tariffs are regulated by the independent EWURA, which refused tariff increases twice in 2010. How can the government of Tanzania guarantee that the tariffs will increase as required by MCC without impinging upon the regulator’s independence? This promises to be a contentious issue in the near future. On the one hand President Kikwete has insisted that he wants to keep water tariffs low,<sup>46</sup> on the other hand section 3.4(c) of the Compact states that “the Government shall not invoke any of the provisions of its internal law to justify or excuse a failure to perform its duties or responsibilities under this Compact.”<sup>47</sup>

This brief overview of DAWASCO’s inner workings and institutional and political environment only suggests that although formally owned by the government and formally a ‘public’ company, DAWASCO is far from being a public entity politically accountable to, and directed by, users of the city’s water systems. But this is mostly out of DAWASCO’s control: the Tanzanian government is legally required to implement international donors’ policy recommendations and conditions, even if this means unaccountability to the population affected by these decisions.

## Conclusion

The CWS privatisation experience imposed by international donor conditions was a massive failure that resulted from the private operator’s poor preparation, difficult relationships with staff, and shareholder in-fighting. The fact that the Tanzanian government precipitated the termination of the contract in an abrupt manner and used this termination to score political points before a presidential campaign was not enough for the private company to win its two legal claims against Tanzania at UNCITRAL and ICSID, two arbitration courts normally friendly to private investors’ interests.

Given this record, it is a remarkable achievement that its public successor DAWASCO was able to rise from CWS's ashes and reverse the performance trend to increase coverage and revenue, if only partially. However, its strong focus on cost recovery without radical improvements to the system has led to the use of problematic tactics. Performance remains fragile and irregular, direct access to the network remains with a small minority located in the most affluent areas of the city, and the majority of the population has to rely on indirect access at much higher prices. The real improvements come from capital works that are paid for by the central government, itself relying heavily on international development institutions. These institutions impose conditions that shape the system's structural evolution, both technically and ideologically, without being accountable to the users of the systems. In this sense, the remunicipalisation of water in Dar es Salaam is a default situation created by the collapse of a private contract, not a strategic move planned by sovereign political institutions. If political sovereignty is a condition for sustainability, then the limited choices imposed by donor conditionality must be seen as one of the biggest obstacles to solving Dar es Salaam's water woes in the long run.

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**Chapter Four**

# Aguas Públicas: Buenos Aires in Muddled Waters

by Daniel Azpiazu<sup>1</sup> and José Esteban Castro



In 1993 the private consortium *Aguas Argentinas SA* (AASA), headed by the French multinational Suez, was granted a 30-year concession to run the integrated water and sanitation services of the Buenos Aires metropolitan area. At the time it was the largest of such private concessions in the world, serving roughly nine million people in Argentina. The contract was imbued with neoliberal recommendations and was heralded as a flagship privatisation to be replicated in other countries.<sup>2</sup> In what followed, the private operator failed to comply with contractual obligations, but Argentine authorities turned a blind eye. However, in 2006 the government cancelled the AASA concession and then-president Nestor Kirchner returned the responsibility for water and sanitation services to the public sector.

Strictly speaking, the de-privatisation of AASA was not a case of ‘remunicipalisation’. First, the concession had been granted by the federal government and not by municipal authorities. Second, it was taken over by a newly created public company, *Agua y Saneamientos Argentinos* (AySA), under the control of the national government. Nevertheless, the water service operates at a municipal level and lessons learned from this case are relevant to the subject matter of this book. In particular, the case highlights how the privatisation of water and sanitation makes it difficult to reorganise around public objectives, especially those of subordinating profitability to higher social priorities of universal access to quality water services.

In the first part of the chapter we review key aspects of AASA’s concession to contextualise the cancellation of the private contract. We then analyse the long and conflictive process of contract renegotiation that took place between 2002 and 2006, involving not only the national government, Congress and the private operator but also foreign governments, international tribunals, workers’ unions (mainly the Sanitary Works Union of the Great Buenos Aires, SEGBATOS), non-governmental organisations and independent public institutions, among others. Part three reviews problems associated with the normative and regulatory institutions that emerged with renationalisation and the creation of AySA. Finally, the performance and main characteristics of the public operator are examined. We conclude by drawing lessons from Buenos Aires’ disastrous experience with privatisation and how this affects shifts to public water services.

### **Cashing in on poor performance**

The troublesome history of the AASA concession can be divided in two periods: from 1993-2002, and from 2002-2006. The first period was characterised by recurring contractual modifications, mostly associated with tariff increases and by repeated government complaints about AASA’s failure to honour the contract in relation to investment commitments, expansion targets, environmental protection and service quality, among other issues. Yet, authorities showed leniency in face of the financial strategy adopted by

the private operator, which would come to have disastrous consequences. This period was marked by the systematic subordination of authorities to the interests of the private operator, with initial government complacency turning into an unwillingness to pay the political cost of interrupting an emblematic privatisation effort. The second period concerns the long-delayed process of contract renegotiation that was triggered by the abandonment of fixed parity of the Argentine peso with the US dollar.

The terms of the original concession, the main modifications introduced afterwards, and the underlying drivers of the concessionaire's strategy help understand the dynamics of these two periods. In a nutshell, in the original contract the operator committed to: 1) universalisation of access by 2023 (100% coverage for water from 70% in 1993 and 95% from 58% for sewerage); 2) improvement of service quality to meet international standards; and 3) incorporation of new technologies for wastewater treatment. This was to be achieved while maintaining "reasonable" services tariffs, with an initial reduction of 26.9% of the existing tariff.<sup>3</sup>

The original contract divided the life of the concession into six five-year periods, and contract revisions were to take place at the end of each period to verify the operator's compliance with expansion targets, investments, and the tariff freeze that was integral to the original bid. However, the first 10 years of the concession were subsequently exempted from the tariff freeze requirement as requested in the private company's offer. Monitoring compliance was to be the shared responsibility of the service regulator and of the Tripartite Entity for Sanitary Works and Services (ETOSS, in its Spanish acronym), according to the Regulatory Framework set by Decree 999/1992.

As for the quality of water supply and sewerage services the contract adopted the physical-chemical and bacteriological parameters recommended by the World Health Organisation. Specific environmental protection measures were agreed to, which required the concessionary to build wastewater treatment plants with the objective of progressively eliminating the pollution of water sources. Tariff regulation was based on a mean income per user cap for the private operator whereby ETOSS could demand tariff reductions if this income were to exceed a set level. As with many other terms of the original contract, this criterion was modified in contractual renegotiations in following years, much to the benefit of the private company.

The contract also established two possibilities to grant tariff adjustments: "ordinary" and "extraordinary." The former would be considered during the performance reviews at the end of the five-year periods, while the latter could be granted in cases of changes in the company's operational costs as measured by a special index. Before the end of the first year of the concession AASA requested an "extraordinary revision" of the tariff arguing that it had suffered unforeseen operational losses and ETOSS allowed a 13.5% tariff

increase, on top of a considerable rise in the fixed “infrastructure charge” levied on newly connected users.<sup>4</sup>

From then on, AASA’s concession was characterised by a worsening record of non-compliance with contractual targets, particularly regarding the pace of investments, the expansion of coverage, and the quality of services. It was also marked by the operator’s relentless pressure to squeeze concessions from the authorities, including demands to ‘dollarise’ the tariffs and to tackle widespread non-payment of the infrastructure charge by newly connected users. The government responded favourably to the company’s demands and in 1997 set up a process to renegotiate the concession contract that brought about substantive modifications to the original terms (Decrees 149/97 and 1167). The renegotiations continued between 1997 and 1999, resulting in additional modifications to respond to the private operator’s interests. The new terms of the contract included: the effective dollarisation of the tariff that came to tie directly to the evolution of a US price index; the elimination of the regulatory principle that capped the mean income per user; the provision for yearly “extraordinary revisions” of the contract; and the cancellation or postponement of investment commitments originally agreed to. In this context, the first five-year review originally scheduled for 1998 was delayed until 2001, when a new Five-Year Plan was negotiated behind closed doors between AASA and ETOSS. The new plan contemplated additional tariff increases as requested by the operator to comply with the investment targets, including new fixed charges.

During the period 1993-2002, ETOSS estimates that AASA only met 60.9% of its contractual investment and expansion targets; a poor performance considering that this figure was calculated on the basis of the lower renegotiated investment commitments (ETOSS, 2003). In terms of environmental protection, AASA did not deliver on these commitments either, with dangerous substances (such as arsenic, cyanide, heavy metals and nitrates) remaining well above recommended World Health Organisation levels. As a case in point, AASA had not assessed potential environmental impacts when it decided to close a number of underground water wells in the southern area of Greater Buenos Aires, leaving municipalities reliant on water supplies pumped from La Plata River. This decision eventually caused a rise of the water table, which led to flooding of buildings and streets in the municipalities of Lomas de Zamora, Quilmes and Morón; it also worsened the pollution of the underground water sources in the region. In 2001 the municipality of Berazategui presented a lawsuit against AASA for failing to comply with the original contractual commitments to build adequate treatment facilities for the sewage that was still being released untreated into La Plata. Later on, evidence of this type of negative environmental impacts of AASA’s activities would contribute to the cancellation of the contract.<sup>5</sup>

Lack of compliance with the original commitments was also reflected in the failure to meet expansion targets. The target for water supply was to increase coverage from 70%

to 88% by 2002, but it had only risen to 79% by then. The target for sewerage was to increase coverage from 58% to 74%, but it barely reached 63%. This means that by 2002, 800,000 people were still left without access to water, and more than one million without sewerage services. The figure is substantially higher if we consider the original targets for primary wastewater treatment for which AASA complied only at 7%, thus leaving more than six million people without this service.<sup>6</sup>

Another indicator of poor performance is the increasingly regressive evolution of the tariff. First, between May 1993 and January 2002 the mean residential tariff increased by 87.9%, while during the same period the Consumer Price Index only increased by 7.3%. Second, during the contract renegotiations a number of progressive tariff criteria that provided some level of cross-subsidy to support lower income users were removed, and this is reflected in the impact of the tariff hikes on different groups of users. In the same period, the basic tariff increased by 177% and the average bill by 62%, but high consumption users only saw a 44% rise.<sup>7</sup>

Under these conditions, the private company cashed in on a mean profit rate of more than 20% over net assets and around 13.3% over aggregated revenues between 1994 and 2001. Low price elasticity of demand and relative stability of consumption, coupled with null risk guaranteed by the complacency and leniency of the regulatory authorities, meant that AASA was allowed to make extraordinary profits while failing to deliver on contractual commitments. AASA also minimised the use of its own private resources and accumulated a disproportionate level of debt to fund the investments. Between May 1993 and December 2001, only 2.6% of AASA's total investments came from its own funds. The company acquired huge debts well above the maximum levels permitted in the original contract, mostly with multilateral financial bodies at interest rates much lower than those available in the local market. This strategy would eventually have disastrous results, not least because AASA dismissed the potential risks of future devaluations. Thus, when the peso-dollar parity was ended in 2002 the private operator faced a debt of US\$700 million, which then represented over three years of gross revenue and over 20 times the net value of the company. This also explains why in 2002 AASA's account deficit was 13% higher than the total amount billed that year.

To summarise, the first period of the concession was marked by a series of contractual modifications, mostly related to tariff increases, and by a lack of compliance with investment commitments, expansion targets, environmental protection and service quality. All the while, the company was stacking up profits and debts.

### **The renationalisation saga**

The passage of the Law of Economic Emergency and Exchange Regime (Law 25561)

in early 2002 triggered the cancellation of AASA's contract. The legislation ended fixed parity between the Argentine peso and the US dollar and established a new operational context for companies privatised during the 1990s. In particular, it cancelled the indexing mechanisms previously enforced to increase tariffs and reverted to local currency public service tariffs (*pesificación*). It stipulated that all contracts with privatised companies would be subject to renegotiation but in the meantime private operators could not suspend or alter the terms of compliance with their contractual obligations.

In this context, the AASA renegotiation entered a complex stage. The private company reacted immediately by putting pressure on the government, directly and through its foreign shareholders, notably appealing to the World Bank's International Centre for Settlement of Investment Disputes (ICSID).<sup>8</sup> In addition, the governments of the countries where shareholders were based, especially France, rallied with the International Monetary Fund (IMF) to press Argentina to resolve the matter to AASA's advantage. These developments imposed severe restrictions and worsened the conditions for the long-delayed and already conflictive process of contract renegotiation.

AASA had not changed its approach since the 1990s and showed no inclination to accept the loss of the privileges it enjoyed for almost a decade. Within days of the enactment of the new law, AASA prepared an emergency plan and made a number of requests to the government: to provide retroactive insurance to cover its external debt of around US\$700 million, to grant a peso-dollar parity for its imports (mostly internal transactions between foreign and local branches of the consortium companies), and to suspend all investments unilaterally and indiscriminately.<sup>9</sup>

However, when Nestor Kirchner assumed the presidency in 2003 his government seriously considered revoking the contract. There was a strong sense that the privatisations of the 1990s, particularly AASA's, carried a heavy social cost. A number of official reports<sup>10</sup> and evidence gathered by civil society organisations, including user and consumer groups and NGOs, suggested that there was sufficient proof of non-compliance to annul the contract. A number of other options were on the table, for instance private management (preferably with a different shareholder structure) with more state intervention for infrastructure planning and development, or an adapted contract to facilitate the private "management" of the company but to fully transfer the responsibility for infrastructure expansion and maintenance to the government.<sup>11</sup>

Following the 2002 Argentina default on its public debt, a clear priority for the government was to find a solution that would prevent taking charge of AASA's huge debt and that would avert harsh international pressures. Hence, in May 2004 the government signed an agreement that maintained tariff levels, suspended fines for contractual non-compliance and committed to pumping public money into infrastructure works while

binding AASA to suspend its request for arbitration before the ICSID and to present a plan to restructure its external debt.

However, the renegotiation took a new turn in October 2004 when AASA submitted a new proposal that revived the confrontational character of the process. AASA's proposal included a series of steps oriented at reconstituting the economic-financial equilibrium of the concession: a revenue increase of 60% from January 2005; state intervention to obtain a loan for US\$250 million to be repaid in 18 years at an interest rate of 3%, with a three-year holiday period; government commitment to take charge of 48% of future infrastructure investments; and exemption from income tax.

Argentine authorities deemed the proposal unacceptable, marking a turning point in the renegotiations. The process became even more antagonistic in the following months, possibly because the private operator's main shareholders sensed that the ICSID would rule in their favour and against Argentina.<sup>12</sup>

Finally, after mounting confrontations, the government passed Decrees of Necessity and Urgency 303/2006 and 304/2006 in March 2006 to cancel AASA's concession and create the public company AySA under a participatory ownership scheme (the state owns 90% and the workers' union owns 10%) to immediately take responsibility for the provision of water and sanitation services.

### **An imperfect institutional design**

The case of AySA was unique in the series of renationalisations implemented by the Kirchner administration in that it sought to consolidate the operational-institutional environment of the new public company in normative terms. The proposed Regulatory Framework submitted to Congress in November 2006 set sector-specific norms for water and sanitation embedded in a national law rather than relying on *ad hoc* special decrees sanctioned by the executive, as had been the rule during the 1990s. Moreover, it appeared it would allow public debate on water and sanitation and on public goods more broadly. Unfortunately, the impact of this well-intentioned initiative was limited due to a number of factors. In Congress, as much as in society, debate remained limited since the government was able to pass the law quickly thanks to the majority it enjoyed in both chambers.<sup>13</sup> The March 2007 law had a number of important shortcomings in light of existing international standards and experiences. For example, there was no provision for public discussion of the AASA renationalisation process even though there had not previously been massive public mobilisation to end the private concession – with the exception of protests organised by the Coordinator of Neighbourhood Assemblies against *Aguas Argentinas*.

The new legislation created a new regulatory body for monitoring and control, the Water and Sanitation Regulatory Entity (ERAS), within the Ministry of Federal Planning,



Public Investment and Services (MINPLAN). Its three directors were appointed by the federal executive without public competition based on professional merit and without consultation with Congress. Thus, from the start it was clear that the degree of autonomy of the new regulator was seriously compromised. The law also established the creation of the Planning Agency (APLA), also within MINPLAN, with responsibility for the “evaluation, study, planning, projection, execution and control of investments.”<sup>14</sup> The Under Secretariat of Water Resources (SSRH) became the implementing authority with the responsibility for setting water and sanitation tariffs, and its director would be the same as APLA’s.

These considerations illustrate that despite the important advances made through setting up a new public entity, the institutional design of AySA had significant shortcomings. These range from the vague delimitation of incumbencies for the various bodies, aggravated by the multiplication of government agencies involved, to the limitation of the role of the regulator to functions of monitoring and control, to the concentration of the authority for implementation, planning and regulation in the hands of MINPLAN.

Furthermore, the new law does not obligate public consultations for substantial modifications to the system (e.g. alterations in the tariff system or in expansion targets). Participation is limited to consultations organised by the user syndicate, an entity operating voluntarily and constituted by recognised organisations defending user interests. The law provided for the parallel creation of a consumer watchdog entity to represent users in public hearings and judicial or administrative procedures; its head would be appointed through public competition based on professional credentials, a process that only started in late 2010. Clearly, users had little if any opportunity to participate in crucial decisions such as tariff setting or infrastructure planning. When the much delayed incorporation of user representation in ERAS through the consumer watchdog, and to a lesser extent through the user syndicate, finally comes into effect, it will be merely tokenistic unless significant changes are introduced.

Summing up, the creation of AySA permitted important advances, particularly by putting in place a regulatory framework specific to the water and sanitation sector that facilitates control and monitoring. However, the concentration of regulatory and other functions in the hands of the executive strays from international best practice. Today, AySA’s institutional and operational environment is fragmented and all decision making is centralised.

## **Assessing AySA’s performance**

Although AySA is still relatively new, it is useful to assess its performance from the perspective of ‘efficiency’. The conventional, neoclassical understanding of efficiency gives

priority to the profit rate of a stand-alone organisation. We argue that it is necessary to go beyond these narrow confines and to recover a broader meaning of efficiency that includes state subsidies in the provision of essential public goods and services, and recognises the social and environmental benefits of investments that go beyond a single agency or sector.

If we were to accept the neoclassical position, the performance of AASA between 1993 and 2001 would be considered highly efficient, as it delivered a mean profit rate of over 20% on net assets. By contrast, the efficiency of AySA since its creation would be considered negative. Despite receiving direct transfers from the national budget equivalent to 60% of gross revenue, the company's 2010 balance sheet showed losses of 18.5% over gross revenue and 6.6% over net assets.<sup>15</sup> Alternatively, if we give analytical priority to such indicators as the expansion of access to water and sanitation services to achieve essential social objectives, then AySA's performance to date would have to be considered much more 'efficient' than its predecessor's.

When AySA began operations in March 2006 the deficit in service coverage was 16% (1.5 million people) for potable water and 36% (3.5 million people) for sewerage. In response, AySA implemented the Plan for Immediate Action (PIA), involving infrastructure investments of roughly US\$40 million. The PIA had several sub-components and was mainly oriented to: 1) recovering the quality of services (Nitrates Plan), which had deteriorated in some areas due to poor environmental management by AASA; 2) expanding the capacity for treatment and transportation of drinking water and increasing access to new users; and 3) rehabilitating and renewing the infrastructure to guarantee service provision during periods of peak demand.

A more comprehensive roadmap, the Water Supply and Sanitation Master Plan 2006-2020 (WSMP), was launched in October 2006 by President Kirchner. It sets the priority goal of securing rapid universal access to water and sanitation services for AySA. The WSMP is divided into two phases, the Five-Year Plan (2007-2011) and the post-2012 period. The initial Five-Year Plan aims to achieve full universalisation of access to water (connecting 1.5 million new people) by 2012 and expanding the coverage for sewerage to 80% of the population (connecting 1.4 million new people). It also sets targets for improvements in the quality of drinking water and rehabilitation of infrastructure. For 2020, the WSMP aims to extend the coverage for sewerage services to 95% of the population, while also providing for the maintenance and renewal of the infrastructure and improving environmental health. The WSMP represents a total investment of roughly US\$5.7 billion, and funding responsibility is shared by AySA (52%) and the national government (38%), while the Autonomous City of Buenos Aires (5%) and the governments of the Province of Buenos Aires and the conurbated municipalities (5%) also contribute to the effort.

In brief, looking at AySA's economic-financial performance requires one to remember that the *raison d'être* of the company is not to make profit, provide value to private shareholders or become a water and sanitation utility that can compete on international markets. AySA's aim is to universalise access in the Buenos Aires metropolitan area by 2020 and, as such, it forms part of a political program that prioritises public and environmental health and well-being. The national government has committed to huge investments to meet these goals because it concluded that sufficient funding cannot come from AySA's revenues. Concretely, the federal government has granted increased transfers, which in 2009 amounted to roughly US\$137 million and were projected to rise to US\$340 million in 2010.

Crucial political decisions will have to be made to balance between the possibility of economic-financial self-sufficiency of the company and the higher societal goals set by the WSMP for 2020. It is important to critically evaluate the current economic-financial model in order to anticipate potential problems that may jeopardise the future performance of the utility and, consequently, the ability of the government to meet the targets. Among the key factors that influence AySA's chances of meeting its objectives are the infrastructure programs funded by the National Entity for Sanitation Water Works (ENOHSA) and tariff policies, to which we turn now.

### *Tariff policy*

The WSMP explicitly recognises that AySA's revenues will not be sufficient to fund the investments needed to meet its ambitious targets, which has proven true since 2007 as revenues have been consistently lower than operational costs.<sup>16</sup> This situation calls for a critical examination of the present tariff structure. A revision of tariffs could help to introduce more equity and solidarity among users, induce more rational water use, and allow for a reduction in the contribution required from the national budget to reallocate resources in priority areas.

It is worth recalling that water and sanitation tariffs have been frozen since January 2002, while the Consumer Price Index has increased by 150% as of November 2010. It is evident that the policy has had a significant impact on the company's revenue. Moreover, the tariff structure was inherited from AASA, which, as explained earlier, showed a number of distortions due to regressive fixed charges introduced during the renegotiations of the original contract. An unexpected outcome of the decision to maintain the tariff structure has been the entrenchment of unacceptable inequalities in the system, inequalities that have been substantially worsened by the effect of the tariff freeze. This situation is particularly noticeable in the case of the so-called 'free tap' (*canilla libre*) system, in use by high volume and high income users. In addition to the long overdue review of all fixed charges introduced during AASA's concession, it would have been important to update and extend

the value of some tariff components that are responsible for ensuring a higher degree of fairness in the system. In particular, tariff formula coefficients ‘Z’ (socio-economic conditions of the area as proxy for user payment capacity) and ‘E’ (quality and age of the building), which in principle provide the mechanism to charge more to high-income users than to poor users, should have been reviewed because they have proved insufficient. In other words, there is a need to update and extend the system of cross-subsidies that was part of the original tariff structure adopted at privatisation but that was later abandoned through the successive contract renegotiations. This is important not only to establish a fairer charging system but also to induce a more rational use of the services given that the tariff freeze has brought about a substantial drop in the cost of water and sanitation services for users, which tends to promote wasteful water use particularly among the well-off. Until tariff structures are re-evaluated and actual consumption is metered, it is hard to see how AySA campaigns for user education about water use can be effective.

Granted, some efforts were made to redress imbalances in the tariff structure inherited from the 1990s. For instance, the first “ordinary” contract renegotiation with AASA in 2001 introduced a Social Tariff that was implemented the following year. This tariff is targeted to vulnerable families that cannot afford to pay the cost of the services, and its application involves a complex set of actors including the WSS utility, the regulator, user and consumer bodies, neighbourhood associations, and local authorities. The tariff consists of a subsidy that varies according to the needs and characteristics of the households. Until 2008 the number of beneficiaries of the scheme ranged between 100,000-120,000 households but in 2009 the figure dropped to 57,329 households, receiving an average subsidy of US\$2.90 per month.<sup>17</sup> This could be explained as the combined result of the drop in WSS bills caused by the tariff freeze and the clear improvement in the socio-economic conditions of poorer families recorded in recent years. However, the Social Tariff is just one among many programs targeted to protect the needs of the poorer users that were initially implemented to counter the impact of privatisation.

### *Infrastructure and expansion of access*

Current infrastructure and access initiatives are the product of the first five-year review, originally scheduled in the AASA privatisation contract to take place in 1998 but only completed in 2001, that brought about a renegotiation of key aspects of the agreement. Indeed, this process generated a number of new initiatives aimed at compensating for the failures of the private company to deliver on targets originally agreed to regarding the expansion of coverage to low income sectors. These initiatives were to be publicly funded or based on the provision of labour and resources by the communities themselves; for instance the Participatory Management Model (MPG), also known as the Plan for Poor Neighbourhoods, was initiated in 2003 and the Water+Work Plan funded by ENOHSA was implemented in 2004 and taken over by AySA in May 2007.

The MPG is organised through the shared work of AySA, the municipalities and neighbourhood communities, with neighbours providing the labour force to receive discounts on water and sanitation bills in return. The MPG is almost fully funded by AySA who also provides the technical supervision of the works, and its objective is to expand water and sanitation coverage to very poor communities. Although the impact of the MPG has been modest it has nonetheless allowed the connection of around 44,000 people to the water supply and around half as many to the sewerage network.

More importantly, the Water+Work Plan has played a significant role in the expansion of the water network in recent years. This plan has multiple objectives, including the alleviation of the sanitary risk affecting the population lacking access to water and sanitation services, reducing the cost of network expansion in low income neighbourhoods, and the promotion of job opportunities through the creation of cooperatives. Since 2007, AySA funds and contributes to the design and supervision of infrastructure works while labour is provided by work cooperatives. These cooperatives are integrated by neighbours who are beneficiaries of social assistance or unemployed without welfare benefits. The SEGBATOS also plays an important role in the training of the cooperative workers, while the municipalities are in charge of leading the projects. Since the creation of AySA in 2006, the Water+Work Plan has helped to connect over 330,000 people to the water supply network, and it is expected that an additional 550,000 will be connected through projects that started in late 2009.<sup>18</sup> This is a major contribution toward the objectives set by the government in the WSMP. Building on this success, the sister plan Sewerage+Oriented Work was started in 2008. This initiative involves a number of ongoing projects that are expected to connect over 16,000 people to the sewerage network in the Buenos Aires conurbated municipalities in the near future.<sup>19</sup>

A common characteristic of these programs is the direct involvement of residents, mostly from vulnerable communities, and their technical training to expand the water supply and sewerage networks and to improve access to the services provided by AySA. They give a significant boost to the central objectives set by the government in the Five-Year Plan (2007-2011), as a first step toward the universalisation of provision by 2020. By the end of 2009, AySA was able to connect over 540,000 people to the water supply network. Through the projects already being implemented it plans to extend the service to 415,000 more people by the end of 2011. In relation to sewerage, a total of 77,285 users were connected by late 2009, and AySA's current projects will include over 525,000 people by 2011. Thus, APLA authorities are confident that the targets set in the Five-Year Plan will be met.<sup>20</sup>

### *Bringing workers on board*

AySA's operational performance is strongly dependent on the collaboration of the SEGBATOS workers' union, a union that played an active role in the privatisation of the

utility in the 1990s when it was promised a share of 10% on the privatised utility. The company's president, Dr Carlos Ben, is closely associated with the union and was himself a member of the committee in charge of the privatisation program and later adjunct director of AASA. This strong involvement of Ben and the union in the business of the privatised utility is recurrently commented upon by critics who see worrying continuities with the past in the running of the renationalised utility. These problems are difficult to ignore. The national government has tried to dismiss these criticisms, notably in a speech delivered by Kirchner during the public announcement of the WSMP on October 12, 2006:

I do not have any doubt that the workers of the company AySA, working with the Argentinean people, with the providers, and through the public bids that we will be launching, will give a true example of what Argentines are able to do. I am absolutely convinced.<sup>21</sup>

It should be noted that AySA's workforce has grown steadily, from 4,058 employees in 2006 to 4,596 in 2009. This is not far from the numbers reached during the privatisation period, with 4,267 AASA workers in 1998.<sup>22</sup> Considering the level of productivity as measured by the ratio between cubic meters of raw water produced per day to the number of workers, AySA's current performance shows positive trends: slightly over 1000 m<sup>3</sup> per worker as compared to 968.4 m<sup>3</sup> per worker recorded by AASA in 1998.<sup>23</sup>

AySA's technicians and professionals benefit from a diversity of training programs organised with the active participation of SEGBATOS, covering technical, commercial, and administrative aspects. Also, there are training workshops for skilled workers in welding, mechanics and electro-mechanics, among other areas. The hours of training provided through these programs to AySA's workforce have significantly increased, from 21,874 hours in 2006 to 60,000 hours in 2009.<sup>24</sup> Moreover, the evidence suggests that AySA has been diligent in developing better working conditions in terms of safety and hygiene.

## Conclusion

The recent experience with water and sanitation services in the Buenos Aires metropolitan area reveals useful lessons about rebuilding public utilities in the aftermath of privatisation. The case of Argentina is particularly valuable because of the abrupt changes in the macroeconomic, social and political contexts, forcing us to examine the ruptures and continuities between 1990s neoliberalism and post-2002 state-led economic and social policies.

A wealth of literature has been dedicated to the performance of AASA, and we have only reviewed some of its key aspects here. The main conclusions are that the privatised company failed to comply with contractual obligations and followed a strategy driven

by the pursuit of extraordinary profits. This strategy was successful for AASA during the period of forced stability of the Argentine currency (1993-2001), but imploded with the collapse of the neoliberal model in 2002. The economic, financial, environmental, political and social costs of the privatisation of Buenos Aires' water and sanitation services have yet to be fully understood, but evidence shows that these costs were very high and will compromise the ability of Argentina to achieve universalisation of essential public services by 2020.<sup>25</sup>

In this respect, an example of the structural (and structuring) conditions that constitute the legacies of the neoliberal period are the different binding agreements signed by countries like Argentina to protect foreign investments, notably bilateral investment promotion and protection agreements (IPPAs).<sup>26</sup> These agreements have allowed private corporations such as Suez to sue governments that decide to terminate privatisation contracts even if the cancellation of the contract is justified by non-compliance on the part of the private operator. Argentina alone is facing dozens of such cases presented to the ICSID, including those by corporations like Enron that face corruption and money laundering charges in the United States but thanks to the IPPAs have a right to seek compensation in countries of the South.

The performance of AySA since 2006 is therefore marked by the tension between laudable efforts on the part of the national government to prioritise the universalisation of water services on one side, and the drag exerted by the legacies of privatisation on the other. Be it because of the inertia of high-ranking cadres initially associated with the privatisation experiment continuing to exert their influence on policy and operation, or the irrational tariff structure inherited from AASA, or the negative environmental impacts of contract non-compliance, the positive effects of bringing services back under public control have been limited by the institutional framework adopted for the public sector provider.

There is a need to improve the strategic planning of AySA's activities by incorporating all relevant dimensions of water services, particularly environmental issues which, although formally integrated, have been neglected in practice. AySA is under mounting pressure to take a more active role in the integral management of the metropolitan river basins that were historically abandoned and are now heavily polluted. A ruling by the Supreme Court passed in 2008 has ordered the government to take the necessary measures to clean up the highly polluted Matanza-Riachuelo basin, which raises the cost of water management exponentially in the Buenos Aires metropolitan area but also has very significant implications elsewhere. This decision came after long-standing mobilisation by a broad alliance of citizen organisations, water users, NGOs, local governments and environmental groups. This has serious implications for the future of AySA's management structures and performance and the public utility will have to consider pleas for institutionalised

mechanisms for meaningful user participation in pursuit of democratisation of water governance in the country.

These problems notwithstanding, renationalisation of the water and sanitation utility in Buenos Aires has brought about important and necessary transformations in the way these services are governed and managed, which offers important lessons for similar renationalisation or remunicipalisation projects elsewhere. AySA's mandate stems from a political decision made by the national government that introduced significant changes to the status of water and sanitation services. Those services are now formally recognised as human rights and as public goods that cannot be treated as commodities governed by market forces. There remain enormous challenges on the ground, but the government is working along with the utility to achieve the full universalisation of essential services. The case of AySA contains many lessons about the challenges and opportunities facing governments left to pick up the bits and pieces bequeathed by weakly regulated privatisation processes, and how they can deliver the universal quality services required for civilised life in the 21st century.

## Endnotes

- 1 Daniel Azpiazu passed away shortly after completing his work on this chapter. As a researcher committed to the defence of the public good he made a substantial contribution to the understanding of the causes of socio-economic inequality and injustice in Argentina, including those associated with the privatisation of essential public services.
- 2 Idelovitch, E. and Ringskog, K. (1995) *Private sector participation in water supply and sanitation in Latin America*. Washington, DC: World Bank.
- 3 Resolution 155/1992 from the Secretariat of Public Works and Communications (SOPyC) granted the concession to AASA; the Resolution was confirmed by Decree 787/1993 from the National Government.
- 4 ETOSS (Ente Tripartito de Obras y Servicios Sanitarios), Resolution 81/1994.
- 5 Decree of Necessity and Urgency 303/2006.
- 6 ETOSS (2003) *Informe sobre el grado de cumplimiento alcanzado por el contrato de concesión de Aguas Argentinas S.A.*, Nota UNIREN, no. 73. Buenos Aires: ETOSS.
- 7 CRCOSP (Comisión de Renegociación de Contratos de Obras y Servicios Públicos) (2003) *Informe del equipo técnico y análisis, sector agua y saneamiento sobre el procedimiento de documento de consulta de Aguas Argentinas S.A.* Buenos Aires: CRCOSP. [http://www.mecon.gov.ar/crc/inf\\_doc\\_cons\\_aguas.pdf](http://www.mecon.gov.ar/crc/inf_doc_cons_aguas.pdf) (accessed 12 December 2011).
- 8 AASA's main shareholders filed their case to the ICSID as Suez, *Sociedad General de Aguas de Barcelona S.A.* and Vivendi Universal S.A v. Argentine Republic (ICSID Case No. ARB/03/19); others such as Anglian Water Limited presented it before the United Nations Commission on International Trade Law (UNCITRAL).



- 9 AASA (Aguas Argentinas S. A.) (2002) *Respuesta a la información solicitada por el Ministerio de Economía por medio de la guía de procedimientos*. Resumen Ejecutivo. Buenos Aires: AASA; Azpiazu, D. and Porcinito, K. (2004) Historia de un fracaso: La privatización del sistema de agua y saneamiento en el Área Metropolitana de Buenos Aires. In Azpiazu, D., Catenazzi, A. and Forcinito, K. (Eds.), *Recursos Públicos, Negocios Privados. Agua Potable y Saneamiento Ambiental en el AMBA*. Los Polvorines, Buenos Aires: Universidad Nacional de General Sarmiento.
- 10 See for example AGN (Auditoría General de la Nación) (2003) *Resolución 185*. Buenos Aires: AGN. <http://www.agn.gov.ar/informes/Aguas.PDF> (accessed 12 December 2011); CRCOSP (2003), *op.cit.*; DPN (Defensor del Pueblo de la Nación) (2003) *Informe sobre el servicio de agua potable y cloacas*. Buenos Aires: DPN. <http://www.dpn.gov.ar/areas.php?id=58&ms=area4> (accessed 12 December 2011).
- 11 Azpiazu, D., Schorr, M., Crenzel, E., Forte, G. and Marín, J.C. (2005) Agua potable y saneamiento en Argentina. Privatizaciones, crisis, inequidades e incertidumbre futura. *Cuadernos del CENDES* 59(22): 45-68.
- 12 The case presented by AASA before the ICSID (Case No. ARB/03/19) is still pending at the time of writing this paper (April 2011).
- 13 CELS (Centro de Estudios Legales y Sociales) (2007) *Derechos humanos en Argentina*. Buenos Aires: CELS-Siglo Veintiuno Editores Argentina; debate in Congress, however, helped clarify the nature of the new public company and avoid potential conflicts of interpretation. It led to the passing of Decree 373/06 where AySA is clearly defined as a public enterprise of social interest, and the company's shares in state hands were declared non-transferable.
- 14 Decree 373/06.
- 15 AySA (Agua y Saneamientos Argentinos S. A.) (2009a) *Informes anuales*. Buenos Aires: AySA.
- 16 AySA (2009b) *Informes al usuario*. Buenos Aires: AySA.
- 17 *Idem*.
- 18 *Idem*.
- 19 AySA (2009a), *op.cit.*
- 20 *Idem*.
- 21 Kirchner, N. (2006) Speech by President Nestor Kirchner during the public announcement of the creation of Argentina's Water and Sanitation Master Plan, Buenos Aires, 12 October.
- 22 Senén González, C. (2000) *Privatizaciones y relaciones laborales en empresas privatizadas de la Argentina. Los casos de las telecomunicaciones, el agua y el saneamiento*. Buenos Aires: University of Buenos Aires.
- 23 *Idem*; figures are author's own elaboration on the basis of AySA (2009a), *op.cit.*
- 24 AySA (2009a), *op.cit.*
- 25 Castro, J.E. (2009) Systemic conditions and public policy in the water and sanitation sector. In Castro, J.E. and Heller, L. (Eds.), *Water and sanitation services: Public policy and management*, pp. 19-37. London and Sterling, VA: Earthscan.
- 26 Although these types of agreements obviously existed before the neoliberal period, their growing significance and scale since the 1980s are unprecedented. A single country like Chile has assigned hundreds of such agreements, which according to analysts will curtail the capacity of the government to take sovereign decisions even in strategic areas for decades to come.

**Chapter Five**

Who takes the risks?  
Water remunicipalisation  
in Hamilton, Canada

by Martin Pigeon



In 2004, the Canadian city of Hamilton decided not to renew the contract it had rubber-stamped 10 years earlier with a local private water company, Philip Utilities Management Corporation, for the maintenance and operation of its water and wastewater treatment plant. At the time of its signature, this public-private partnership contract was the biggest in North America and brought high hopes for the city's development. However, these promises soon gave way to disappointment and confusion: the contract changed hands several times, the workforce was cut by more than half and operational failures accumulated.

Despite these shortcomings, the decision not to renew the contract did not come easily. In fact, a majority of the municipal council remained in favour of private sector involvement. What made the difference was the sustained campaign of local civil society groups and a handful of local politicians who pointed at the previous contract's flaws and at the operational failures of the private operators. Growing awareness of these problems forced a shift of the allocation of risks to the private sector, making it economically unattractive for private operators to bid on the new tender. And since no company was interested in taking on the full liabilities associated with the contract, the city had no choice but to take it back in-house.

This chapter explains why and how the privatisation occurred in the first place, followed by a detailed account of the remunicipalisation campaign and an assessment of the new water systems' achievements and challenges since.

## **Hamilton and its water systems**

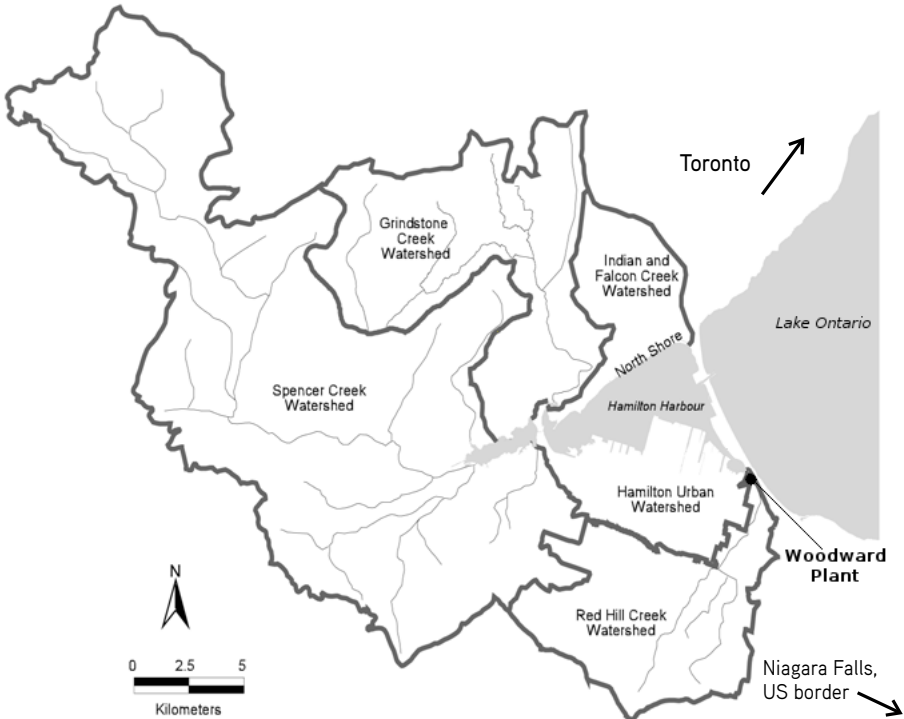
Hamilton is a medium-sized port city of 490,000 inhabitants located at the south-west end of Lake Ontario in Canada, halfway between Toronto and the US border. Founded at the beginning of the 19th century, the city became a heavy industry centre, developing large steel facilities producing 60% of the steel made in Canada. Although still prominent in Hamilton's skyline and air composition, the steel mills and their supplying plants no longer have the importance they once had in terms of employment and contribution to the region's wealth. The city is in the midst of an economic transition marked by its industrial pollution legacy, high unemployment and relative poverty (it has the lowest average household income in the province). A certain social polarisation can be observed between the working class neighbourhoods of the old city on the shores of Lake Ontario, and the relatively recent affluent ones perched on the Niagara Escarpment. The city was amalgamated with its six immediate municipal neighbours in 2000-2001, following pressures by the Ontario provincial government to cut administrative costs.

Hamilton gets almost all its water from a deep-water intake pipe in Lake Ontario, some distance offshore. Water quality in the Great Lakes was not always good – with neigh-

bouring Lake Erie being declared biologically dead in the 1970s – but according to current managers of the city’s water systems quality at source is now satisfactory and the water only needs bacterial treatment to reach drinking quality (regulated at the provincial level). The quantity of water available has not historically been a problem, although increasing draw on the Great Lakes basin has been contributing to lower water levels, which could affect Hamilton in the future.

A unique feature of Hamilton’s water systems is the fact that almost all drinking water and wastewater is treated in one combined plant, the Woodward plant next to the dyke between Lake Ontario and Hamilton Harbour (see map). First built in 1860, the plant has since supplied water to all Hamiltonians as well as sustained the city’s industrial prosperity. On the downside, it has become one of the main point sources of pollution in the harbour, which was listed as a Great Lakes Area of Concern in the 1987 Protocol of the US-Canada Water Quality Agreement.<sup>1</sup>

### Hamilton Harbour Watershed



Source: Adapted from the Hamilton Harbour Remedial Action Plan Report, 2010 update.

In 1994, an economic downturn put the municipality in a difficult financial situation, worsening an already burdensome legacy: the poor state of the water and wastewater infrastructure resulting from the lack of investment and maintenance by previous city managers. The systems were in dire need of repair and replacement, but little funding had been set aside for this purpose, and raising taxes is never an easy political decision, even less so during a municipal election year. This was the situation the councillors faced when they were approached by a local waste management and metals recycling company with almost no experience in water management, Philip Environmental, which proposed to take over the management, operation and maintenance of the water and wastewater plants. Philip Environmental promised savings on the systems' running as well as the creation of a world-leading water company through the biggest public-private partnership in North America's water sector at the time.<sup>2</sup> Attracted by the prospect of outsourcing the problem to a third party, convinced by lobbying efforts involving 'independent consultants', and seduced by the idea of potential personal gain,<sup>3</sup> city leaders signed a 10-year, \$180-million contract on December 30, 1994, despite the opposition of unions<sup>4</sup> and most of the water services staff.

### **1994-2004: A study in water privatisation shortcomings**

The public-private contract was signed between the Region of Hamilton-Wentworth and the newly created Philip Utilities Management Corporation (PUMC), owned at 70% by Philip Environmental and 30% by the Ontario Teachers' Pension Plan Board. This deal was the outcome of intense political networking; PUMC was presided by the former chair of the province's Liberal Party, Stuart Smith, who had previously headed a privatised federal research centre merged with Philip Environmental, the Wastewater Technology Centre.

This was the first contract of its kind in decades in Canada and it was signed without tender or public debate. PUMC was assigned the task to manage, operate and maintain the water treatment facility, the three wastewater treatment plants and the 129 pumping stations of the systems, the rest of the infrastructure (distribution network and laboratories) falling under public management. The idea behind the deal was that the Region of Hamilton-Wentworth would help PUMC become a global player in the water sector, in the hope that this would benefit the city at large. As the region's then-chief of water services put it, "the basis of the negotiations was essentially to develop a contract that would allow a local firm to develop expertise and experience in the contract operations of a major municipality's water and wastewater facilities, while providing the Region with a vehicle for economic development."<sup>5</sup>

Given that this contract was framed in a spirit of mutual cooperation rather than creating an arms-length relationship, it contained numerous clauses that provided for highly

unusual advantages to the private party. For instance, a clause stated that any expense above C\$10,000 was considered a capital expense without further specification; reporting requirements to the city and the province were vague and no public disclosure of this type of expense was required. The city was to bear the cost of most capital investments but the benefits were returned to PUMC in very favourable cost savings allocations. Another remarkable point was liability exemptions: according to two comprehensive reports<sup>6</sup> PUMC could not be held liable for any accident arising from factors such as the plants' capacity limits, the effluents' quality or the city's failure to make "capital, regulatory or emergency expenditures."<sup>7</sup>

In return, the company promised to establish its headquarters in Hamilton, to develop environmental business and international training centres, to create 100 jobs in the region (this clause only applied to Philip Environmental, PUMC's parent company), and to maintain jobs at the facilities for at least 18 months.

But this mutual collaborative vision turned out to be naive at best, with PUMC's behaviour later proving plainly opportunistic. The first assessment by the regional government showed that,

the performance of PUMC during its first year of contract operations has been significantly below expectations. The relationship has been consistently confrontational, difficult, tense and frustrating. In our opinion, PUMC's focus on this contract has been changing from a cooperative spirit of business development and economic development to one of profitability only.<sup>8</sup>

PUMC management practices in subsequent years were no better. In April 1996 the workforce was cut in half, from 120 to 60. In January 1996 the worst wastewater spill in the plant's history sent 180 million litres of raw sewage into the Hamilton harbour and surrounding areas, affecting homes and businesses alike. Yet PUMC avoided any liability thanks to the contract's wide exemptions, and the cleanup costs were borne by the city. Several other spills reported in the following years were accompanied by similar hands-off responses from PUMC. These accidents should not be seen as unfortunate exceptions but as part of an organised risk management practice: PUMC simply adapted to its legal, institutional and technical environment to extract as much profit as possible from the yearly C\$18 million it received from the city to operate.

Technically, PUMC was in charge of the plants, reservoirs and pumping stations, but not of the pipes network. It therefore optimised its costs by pumping faster in non-peak hours, when electricity was cheaper, to fill the reservoirs. The problem is that by doing so PUMC increased pressure in the pipes to levels where there was no security buffer. During these times several main breaks occurred in the pipes network, including one

that affected a hospital and forced partial evacuation of patients, followed by a lawsuit against the city.<sup>9</sup> Additional evidence of technical tricks used to deflect costs was reported by interviewees for this research, with many reporting that PUMC let small maintenance issues (such as lighting) degrade to a point that its repair was costly enough (i.e. above the C\$10,000 threshold) to fall under the city's contractual responsibility.

From a labour point of view, PUMC's employment guarantees were always short term. The massive downsizing of its workforce left several important infrastructure items frequently unmanned, delaying responses in cases of emergencies. In the case of sewage spills, public authorities complained they had not been warned in time on several occasions.<sup>10</sup>

Environmentally speaking, no improvement of the effluents quality was measured during PUMC's operations. On the contrary, ammonia and suspended solids levels in the Hamilton Harbour increased between 1992 and 1998<sup>11</sup> and the frequency of sewer spills increased. From an accountability and transparency point of view, the audited accounts provided by PUMC to the city were not public, preventing elected officials and citizens from accessing them. Union representatives claim that operational logs that monitored the functioning of the plants kept disappearing.<sup>12</sup>

In the end, the only promises PUMC actually kept were to move its headquarters to Hamilton and to expand into the North American municipal water market; it bought 18 other companies between 1994 and 1999, mostly in the United States. But the city of Hamilton appears to have benefited little from this corporate growth. According to a city councillor interviewed in 1998,<sup>13</sup> PUMC had not yet paid a single dollar in taxes.

PUMC's profits were therefore significant, but its parent company (with a name change to Philip Services) was experiencing major losses (C\$1.6 billion in 1998 alone, among the highest in Canadian corporate history). Philip Services had grown quickly, using its good reputation in the financial markets to acquire several other companies, but fraud suspicions hung over one of its directors and triggered a sharp drop in the company's stock value, forcing it to sell assets and file for bankruptcy in 1999.<sup>14</sup> In March of that year, Philip Services sold PUMC for US\$67 million to Azurix Corp, a subsidiary of Texas-based energy giant Enron,<sup>15</sup> created following the purchase of British company Wessex water in 1998, whose launch on public markets in June 1999 showed high ambitions in the water sector.

Those ambitions were short-lived. The company had overestimated its growth objectives, was managed by people unfamiliar with the water business, and proved no match for more experienced and well-connected international competitors.<sup>16</sup> In November 2001, weeks after the (unrelated) Enron accounting scandal<sup>17</sup> broke, the North America branch of Azurix was sold to US company American Water Works (AWW), then bought in

February 2002 by London-based Thames Water, the water group of the German energy conglomerate RWE.<sup>18</sup>

With each new acquisition, the Hamilton City Council had to approve the change of 'partner', but the contract "failed to include clauses providing options for the city in the event of mergers or takeovers by other companies,"<sup>19</sup> and it seems the promises made by PUMC were lost along the way. However, repeated problems, the successive change of owners and the arrival of global corporations to manage the city's water had raised public awareness about water and wastewater management issues.

### **The remunicipalisation campaign**

In 2004, when the 10-year public-private contract came up for renewal, the picture had changed dramatically. The contract originally designed as a cooperative partnership between the city and a local company was now executed by a large foreign company owned by a giant multinational corporation. Moreover, the plants' workforce had been reduced from 120 to a new low of 54 employees, the infrastructure was poorly maintained and the Hamilton Harbour's water quality had not improved. The relationship between the city and AWW, though, had reportedly taken a more constructive tone as the renewal date approached.

In January 2004, city staff presented two distinct proposals to the Public Works Committee and the Hamilton City Council: signing a new long-term contract with a private operator following a public tender, or taking back responsibility for water and wastewater operations. The City Council opted for the former with a clear majority on the basis of typical arguments in favour of private sector efficiencies, innovation and expertise. Senior city officials were in favour of this option too, which was not surprising given that the 2000-2001 amalgamation of Hamilton and its neighbouring cities had seen the city's top managers appointed by pro-privatisation provincial leaders.<sup>20</sup> There was, however, a commitment to preparing a contract that would better serve the city's interests, and law firm Gowling Laffleur Henderson LLP was hired to write the Request for Proposals (RFP) and the Draft Service Agreement (DSA).

In the new contract, the city expected to pay the operator between C\$12 million and C\$17 million annually, compared to C\$18 million with the first contract. Furthermore, companies submitting proposals were requested to comply with all criteria set out in the RFP and the DSA; they would be permitted to submit an alternate proposal at a later stage. Lobbying pressures by the private sector intensified, with various private sector experts brought along from other parts of Canada and abroad (notably by AWW's parent company, Thames Water, but also other potential bidders such as Veolia) to support the city councillors and managers in their decision to renew the contract.



Meanwhile, the city employees in charge of inspecting the plant made internal complaints about the facilities' deterioration and about the municipality's inability to do anything about it. The Canadian Union of Public Employees (CUPE), a vocal critic of privatisation, also put resources into a campaign to pressure the City Council to go back on its decision to contract another private operator. Within the City Council itself, progressive councillors expressed their dissent, including Sam Merulla who represented Hamilton's Ward 4 where the Woodward plant is located.

A civil society coalition called the Hamilton Water Watch Committee was also established. It gathered representatives from NGOs (Canadian Environmental Law Association, Council of Canadians, Canadian Catholics for Development and Peace, Environment Hamilton), labour organisations (CUPE and the local Labour Council), Hamilton East's Member of Parliament Sheila Copps,<sup>21</sup> and concerned citizens and academics in a related group called WATER (Watershed Action Toward Environmental Responsibility). The coalition attended City Council debates, organised events to raise awareness and brought some media attention to the issue.

However, councillors and the media appeared to show little interest in the critiques being made and the pro-public service coalition could not generate meaningful momentum to garner citizen support. The Hamilton Water Watch Committee then decided to change strategy and put its efforts into documenting the flaws of the previous contract and pressuring city bureaucrats to build up as rigorous a tender as possible, at least to limit the economic damage of a future contract. For instance, the coalition supported Councillor Merulla in making a Freedom of Information request<sup>22</sup> to the city to obtain data about the real costs incurred for water and wastewater operations between 1994 and 2004, notably to see to what extent the C\$10,000 clause defining the limit between operating and capital expenses had been abused by the private operator. The data obtained came late and was difficult to interpret, but the move put pressure on the city managers to close this potential loophole in the RFP, which they partially did by raising the ceiling to C\$20,000, with extra conditions that made it more difficult for a private operator to transfer maintenance costs to the city.

Another important tactic of the campaign was to put the spotlight on environmental liabilities, a particularly sensitive topic in the region after the accidental 2000 water contamination by *E. coli* in the neighbouring city of Walkerton that caused the death of seven residents. Responsible management of water-related environmental issues therefore featured high on the agenda, and repeated sewage spills drew negative attention to the private contractor. City officials also addressed this problem in the RFP by partially shifting the liabilities back to the private operator, asking for increased levels of insurance and indemnities in the case of an accident.

In the end, seven companies responded to the city's Request for Qualifications, a pre-screening step to identify interesting bidders, and four companies were short-listed to submit proposals in response to the RFP. Three did so: the existing operator AWW, the French company Veolia, and a Canadian engineering company called ATCO (Alberta-based, owned by global energy company Centrica).

ATCO's offer arrived too late and was rejected. Veolia's bid did not comply with all RFP requirements (the company apparently thinking there was still room for negotiation) and was thus disqualified. AWW's bid complied with the technical specifications but proposed a yearly C\$39 million fee – two to three times the city's original expectations of a C\$12-17 million contract fee! As a result, this bid was excluded as well. Interestingly, an "alternate bid" from AWW for C\$13 million was then put forward, respecting technical conditions but asking that the environmental and maintenance liabilities be shifted back to the city. In other words, the premium they were asking for to cover their risks was about C\$23 million, more than the contract's estimated value.

At this stage, there were no private companies left in the bidding process. The city could not consider AWW's "alternate bid" because it would make itself vulnerable to lawsuits by other bidding companies for breaking the RFP process rules. City staff, at this point, recommended bringing the water and wastewater operations back in-house as soon as the contract with AWW ended. On September 13, 2004, the council's Public Works, Infrastructure and Environment Committee voted 7 to 1 in favour of this option. The city's senior officials were reportedly strongly in favour of re-tendering in the beginning but, according to a city official familiar with the issue, they were shocked by the financial compensation asked by the private companies, which convinced them they could do it much cheaper through municipal management. This insight combined with the strong advocacy of the Hamilton Water Watch Committee probably explains why the City Council resisted the lobbying pressures by Veolia and AWW to reconsider its decision.

This was a major victory for the Hamilton Water Watch Committee and CUPE who saw the remunicipalisation option chosen despite the fact that the council was initially hostile to it. By putting pressure on the city to consider costs and liabilities seriously, it contributed to making the tender economically unattractive for private operators. The operators' risk aversion certainly helped. It was also a victory for Councillor Merulla:

I'm very proud to say that on the first motion I brought forward on this issue, back in 2001, I couldn't even find a seconder, but within three years I was able to successfully do a great deal of work, not only from my part but that of a number of community groups. We were able to put enough pressure, from a public perspective, to have our bureaucracy not only recognise the importance of bringing [water] in-house from an ideological perspective, but also from a safety and fiscal perspective as well.<sup>23</sup>

However, it was a victory that needed to be defended. The council was dissatisfied, being ideologically doubtful of public management, and accompanied its decision with a requirement that the operations be reviewed on an annual basis by using as a reference the very document that was part of the private tender, the DSA. They argued that a review should be communicated annually to the council in a brief and accessible way, and any non-compliance would trigger a contracting-out process.

## Back in public arms

### *Technical and financial performance*

Ironically, the review requirement developed for the RFP proved to be a useful tool in enabling the council to follow operations at the plants more closely once operations were back under public control, providing an annual Report Card with stable indicators over time. Performance was thereby reported upon in clear and transparent terms. Year after year, reports documented impressive performance:

- In 2005 it described how city staff had managed to reach the best cumulated performance over the past 15 years at the treatment facilities while operating below the approved budget of C\$27.7 million, bringing C\$1.2 million savings to the city budget. A similar level of water and wastewater treatment performance would have cost the city C\$195,000 in performance fees for the private operator according to the DSA.
- The 2006 performance report indicated that savings continued to improve, saving another C\$185,000 in performance fees and C\$950,000 on the approved budget of C\$27.9 million.
- In 2007, performance and cost effectiveness increased yet again: \$215,000 saved in performance fees and \$2.34 million saved from the approved budget of C\$30.5 million.
- The 2008 report documented only nine months of operation but showed performance fee savings of C\$75,000 and budget savings of C\$500,000 (from an approved budget of C\$30.2 million).

The Report Card system was dropped after 2008 because investments at the plant had made it substantially different from what it used to be. But overall reports for the period 2005-2008 document total savings of C\$5.66 million from the operating budget. The water department is now self-sustaining economically, with a separate budget from that of the city.

These savings were possible even after the city hired more than 20 workers to compensate for insufficient staffing at the plant. Seventy-five workers now operate the plant in nor-

mal and safe working conditions. Staff dedication is reportedly very strong now, despite difficulties in recruiting well-qualified new employees, a problem encountered throughout the global water sector.

Effluent quality also improved. Performance objectives were deliberately set at the highest technical levels possible for political reasons, to accelerate the city's compliance with the Hamilton Harbour Remedial Action Plan targets and to get the harbour de-listed as a Great Lakes Area of Concern. Ammonia levels in the Woodward plant effluents were reduced by half between 2004 and 2007, reaching an all-time low.<sup>24</sup> The management of water infrastructure was integrated with the Hamilton Harbour cleaning program and resource protection in general. According to Merulla: "Every decision that's made needs to meet a certain threshold related to the social, the health, and environmental aspects and that includes obviously the water and sewer treatment plant capacity."<sup>25</sup>

All problems were not remedied overnight, of course. Wastewater management remains structurally challenging because of combined wastewater and rainwater sewer systems in the lower city that send larger volumes of water into the sewers during heavy rains than the plant can process, forcing the release of insufficiently treated wastewater in the Harbour. The impacts of climate change – with more extreme weather events – are increasingly felt and shed light on the systems' limits: "In Hamilton, we struggle with the kind of wet weather we're getting these days because it totally knocks us off base for several days afterwards,"<sup>26</sup> complains a director of the service. The plant nevertheless produced the best effluent quality in its history in August 2010.

The now-prominent position of water and wastewater issues on the City Council political agenda is reflected in the vast investment program it embarked upon with the help of provincial and national authorities: C\$500-600 million are to be invested in upgrading the plant and expanding its capacity from 2010-15, part of the C\$1.5 billion<sup>27</sup> that is estimated to be needed between 2007 and 2017 to deal with the most pressing problems of Hamilton's water systems. This increased capacity is necessary to enable the plant to process the wastewater coming from new housing and commercial developments south of the city centre. Wastewater treatment will also be improved thanks to an enormous investment in tertiary treatment through the construction of one of the biggest membrane plants in the world; it will be combined with a second combined heat power plant running with the biogas collected during the sludge's digestion. A partnership between the city's water department and Hamilton's McMaster University was established to create a research centre on wastewater treatment with membrane technologies.

These projects come with their own controversies, however. The new wastewater treatment plant will require double its current power supply, generating concerns over its environmental impact. In addition, such a centralised wastewater treatment scheme also

means a concentration of the sludge's pollutants and constantly rising cleanup costs. Sludge disposal remains a problem as well. It was disposed on farm land beginning in 1996 when the city's incinerator was closed down but, as in most industrial countries, farmers are becoming increasingly reluctant to accept this sludge because of consumers' rising awareness of contaminant content. This local resistance, and rumours about upcoming provincial legislation forbidding such sludge application, has fuelled a debate about building a sludge incinerator, with two competing projects. First, the wastewater department managers are planning an expansion of the biogas reactor to generate energy out of the sludge's bio-solids, which would partly alleviate the energy requirement and the sludge disposal problems. Second, a private company, Liberty Energy, is pushing an incinerator project that would also service other municipalities, trucking in sludge from outside Hamilton. At the time of writing (late 2011), debate was still raging,<sup>28</sup> with arguments flowing about the unwanted extra pollution, the cost of another public-private partnership, the damage a 'sludge capital' tag could do to the city's public image, and questions about the transparency and safety of sludge application on farm land.

#### *Transparency, accountability, solidarity*

As demonstrated, the quality of the public water services reporting greatly improved, becoming more readable and also more reliable. Public access to information is also very good, with an impressively vast range of data on the service published on the city's website. This increased transparency is also a source of savings. In an in-house model, transparent evaluation of performance allows re-adjusting budgets annually, whereas in most public-private contracts the operator's annual fee is set once for the full period of the contract. Under such legal terms, good performance by a private operator is harder to verify and it would only profit the company, not the city.

Communication also became a priority of the service: "I can't imagine another community that does more communication with the public than we do. I think we're very good that way,"<sup>29</sup> says a current manager, an assertion backed up by their actions and even a few awards<sup>30</sup> received in recent years. Among the many communication activities implemented, a few are quite telling:

- A call centre was established to provide information and record complaints.
- The increasing number of extreme weather events, flood-causing storms in particular, has led the service to run protective plumbing programs to encourage people to disconnect their home's downspout (the connection between the roof evacuation and the sewer) to try and reduce the volumes of storm water reaching the sewers network in case of heavy storms. A 'flood aware' education and awareness program was set up, proposing flood prevention and remediation tips and resources.

- A campaign encouraging Hamiltonians to drink tap water was launched by the city in 2010 to celebrate the service's 150 years of existence, a very worthy undertaking given the enormous financial and environmental cost of bottled water.

In general, the water department promotes the values of public service; for instance, the three first “values” mentioned in the 2010 business plan are “Equitable access to services by all citizens,” “Honesty, transparency and accountability to Council and the community,” and “Decision making in a responsible, integrated and inclusive manner.”<sup>31</sup>

Problems remain, however. A consultative body established to communicate with the main water plant's neighbours (Community Liaison Committee, CLC) was closed and users say they have not found their way back to the utility's executives. The management says that this was because the CLC had become an “avenue for some to complain about everything,” and that they got fed up with being confronted with systematic criticism when they thought they were doing their best: “It was never good enough.”<sup>32</sup> According to one local environmental activist:

Ironically, we were probably in a better position when the private contractor was in place because there were requirements imposed on them to meet regularly with people in neighbourhoods around the plant...There was a liaison committee that existed really to help people in the immediate neighbourhood to communicate back and forth with concerns and issues that they wanted to see resolved. When the system was remunicipalised, that communication was cut off.<sup>33</sup>

The city now organises one or two open house days per year at the plant, a much more limited channel of communication with the community.

The city nevertheless develops solidarity programs. It manages a fund to help poor people pay their water bills and is proposing loans and grants to help the owners of old homes in the lower city replace their lead connections and pipes (although the fund is modest, only 500-1,000 connections replaced every year of the estimated 24,000 that need new connections). An international solidarity campaign to develop drinking water supply in rural areas in Haiti, headed by the water department, was also launched and is still in operation. A few Mexican water engineers also came to the department for training as part of the solidarity programs.

### *Public service?*

At the time of writing there does not appear to be any campaign to re-privatise water services. On the contrary, all interviewees said that such a move is extremely unlikely, with memories of the failures of the private contractor still vivid and the clear advantages gained by the city in taking the services back in-house having received widespread media coverage.

Notwithstanding this apparent shift to a public ethos, other municipal services, for instance waste collection, continue to be outsourced or set up as public-private partnerships, and the ideological commitment to privatisation still simmers at or near the political surface. There is also a notable trend toward corporatisation of the water service. The billing department was incorporated in 2001 into Horizon Utilities Corporation (HUC), a public electricity company that services Hamilton and neighbouring St. Catharines, and the city acquired 65% of shares through its public company Hamilton Utilities. HUC now collects the bills for both water and electricity. As a result, some Hamiltonians do not realise that their water is publicly managed since HUC behaves and communicates much like a private corporation. This institutional shift was justified on the grounds of cost saving by authorities. However, unionists argue that this corporatisation has caused problems in skills and information sharing between water technicians and bill collectors, decreasing the efficiency of the organisation as a whole. Indeed, the fact that the plant remains publicly managed probably owes less to an ideological shift toward public ownership, or democratic accountability, than to the plant's good technical and financial performance. On the whole, the majority of Hamilton's City Council is still in favour of private sector involvement in public services, or commercialising what is publicly run.

## Conclusion

Despite these concerns, the remunicipalisation of Hamilton's water systems was a major victory for 'public' water movements. Not only has it helped shed light on the often opaque, undemocratic and predatory realities of privatisation, it has given hope to those fighting to reclaim their public services in the face of powerful corporate lobbies and ideologically hostile politicians, by showing them that hard economic facts were on their side once the allocation of risks and profits were clearly defined. The Hamilton experience has also shown how effective and efficient public water management can be, and how quickly things can change when political will and coordinated resistance exist.

Hamilton's water systems are still far from perfect, though, with a technocratic approach to management that might endanger their 'publicness'. Extending these reforms and deepening democratic engagement with the citizens of Hamilton will be critical to sustaining and expanding the public nature of water management in the city and resisting pressures to commercialise the system: public ownership and staff dedication are very important, but public management that thinks beyond the narrow confines of cost recovery is equally critical.

This commitment to 'publicness' is all the more important given Hamilton's long-term infrastructural challenges in the water sector, and the financial pressures associated with it. Major infrastructure upgrades have resulted in significant water tariff increases (7-8%

a year from 2005-2008 and 4% yearly since 2009) but the fact that water services are financially ring-fenced makes it difficult to think more holistically about long-term investment strategies and how these should be paid for. The fact that water and sanitation touch on all aspects of life and link to other services run by the city and other levels of government makes the need to think broadly about the nature of a 'public' service all the more important. The remunicipalisation of water can therefore be used to raise awareness about the need to see public services in their totality and the potential synergies among them, not as silos of activity to be hived off like independent corporations. In this respect, the success of water systems' public management in Hamilton can be used as a launch pad for a larger dialogue on the meaning of 'publicness' and resisting commodification and privatisation in other aspects of people's lives.

## Endnotes

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- 4 The two plant workers' unions were the International Union of Operating Engineers (IUOE), representing the majority of staff, and CUPE.
- 5 Leo Gohier, Acting Commissioner, Regional Environmental Department, quoted in Anderson (1999), *op. cit.*; Loxley (1999), *op. cit.*
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**Chapter Six**

Soggy Politics:  
Making Water 'Public' in Malaysia

by Martin Pigeon



In 2005-2006, the Federal Parliament of Malaysia amended the Constitution and voted in two laws enabling a sweeping reform of the water sector. This reform allowed the federal government to seize all assets previously owned by local water operators, public and private alike, and to fast-track asset development with government funding. Operators would later be offered short lease contracts to manage the revitalised assets, but the objective was to bring the country's water system under tighter public control and oversight.

It is still too early to comment conclusively on the outcome of this long-term restructuring plan, but in-depth interviews with important actors reveal a series of both positive and negative lessons and raise questions about the chosen implementation strategy and assumptions behind the policy change. Malaysia's reform was an attempt at creating a nation-wide public water management system, partly in response to a series of failures on the part of private water companies in the country. At the same time, the reform seeks to create competition among operators and can be seen to facilitate market forces within a unified, and ostensibly de-politicised, governance framework across the country. As such, this nation-wide study of water renationalisation in Malaysia is different from the other municipal-scale cases in this book, but the impacts are felt at the local level and the case raises similar questions about the ideology and politics of moving water from private to public hands.

The chapter begins with a review of the context of Malaysia's water reform and the political dynamics at play. This background helps to explain why prior to 2006, the country's water system was marked by good coverage but uneven technical performance and a controversial track record of private concession contracts. We then examine the ensuing federal reforms in the water sector and the ambitious goals that were set for making water 'public'. While some important gains have been made in this regard, there are troubling questions about the lingering commercialised nature of water management in the country and unrealistic assumptions about depoliticising water.

### **The political context: One party-dominated democracy**

Following its independence from British rule in 1957 and its constitution as Malaysia in 1963, the country became a Westminster-style federal constitutional monarchy, with 13 states and three federal territories. A single coalition of ethnic-based parties called the National Front (*Barisan Nasional*, BN) has dominated political life since independence, under various names, and its member party United Malays National Organisation (UMNO) has played the key role in the coalition (all prime ministers to date have come from this party). Malaysia is a highly multicultural country, with Malays controlling the political system but only representing slightly more than half the population while the

two other large communities are of Chinese (24%, historically the country's economic and business elite) and Indian (7%, mostly Tamils) descent. Political life is partly structured by these demographics, with some pro-Malay policies (*Bumiputera* policies) triggering resentment in other communities.

The Malaysian government has been described by critics as authoritarian and extensively relying on cronyism.<sup>1</sup> Traditional media are mainly controlled by the government and BN parties; however, Internet media is legally protected from censorship and seems to have played a role in reinforcing the opposition in the 2008 elections when it won five states out of 13, including the key prosperous state of Selangor. Organised civil society and social movements exist, but secular organisations are still small and concentrated in the big cities of Kuala Lumpur and Penang, most often involving non-Malay individuals.<sup>2</sup>

Benefiting from its strategic position along the Malacca Strait, one of the most important global trade routes (carrying a fourth of the world's traded goods), Malaysia has been one of the fastest growing economies in Asia since independence, with an average 6.5% yearly growth rate over the past 50 years. Driven initially by exports of natural resources the country's economy has developed into a more multi-sectoral structure with industry being the main growth driver since the 1980s. This growth and diversity was historically state-oriented, but has more recently been heavily privatised. A growing proportion of the population is urban and middle class, with a relatively high Human Development Index for the region.

### **Before water sector reform**

Water is widely available in Malaysia as the country is home to some of the oldest rain-forests on the planet and receives some of the highest levels of rainfall. In 2009, 85.3% of its raw water supply came from rivers,<sup>3</sup> a proportion that is slowly decreasing with more storage dams being built and groundwater exploitation projects underway. Water quality is degrading due to environmental destruction in catchment areas, deforestation and pollution from industry and monoculture crops (particularly palm oil). Available quantities also diminish as a result of climate change. Until 2005, local states had the exclusive responsibility to provide water services to their citizens, often one of their main prerogatives. Overall, water infrastructure development in the country has been technically sound and socially progressive. Since independence, the government has prioritised affordable and universal water supply as a key development objective, and water infrastructure has been included in all of the country's five-year development plans from 1966 onward, enabling drinking water access to jump from roughly 23% of the population in 1950 to 91.6% in 2009 (96.8% for urban users, 86.5% for rural ones).<sup>4</sup> This wide cover-

age has been achieved thanks to federal government interest-free loans to state governments for capital investments, and to state subsidies that allow keeping water tariffs low.

However, some states reportedly abused the federal loans arrangement and used funds for other purposes, a situation translating into high indebtedness<sup>5</sup> and inadequate infrastructure in some places: the state of Pahang, for instance, still has a high leakage rate with 59.9% unaccounted for water in 2009, almost twice the national average of 36.6%.<sup>6</sup> The political sensitivity of water tariffs deterred many of these states from imposing hikes – some have not increased tariffs since the 1980s – thus creating a vicious circle of high indebtedness and degrading system reliability where water tariffs revenue was the main financial resource for maintenance.

Other states, when confronted with fast-growing economic needs from industry and unable (or unwilling) to invest at the desired pace, surfed the privatisation wave that hit the country at the end of the 1980s to grant concession contracts to local private water operators, particularly in the richer and more populated Selangor and Johor states where most industries are concentrated. This enabled fast infrastructure upgrades, but led to repeated, unpopular and anti-poor water tariff hikes, general secrecy around the provision of water services (notably about concession agreements) and growing debt by the private operators who could not convince public authorities to impose high enough tariffs to enable them to recoup their full cost. In addition, empirical evidence shows that efficiency did not improve noticeably in these privatised systems.<sup>7</sup>

Some public systems performed well during that period, the best being *Perbadanan Bekalan Air Pulau Pinang* (PBAPP) in the state of Pulau Pinang, a corporatised but publicly controlled company whose excellent management makes it the benchmark for the country: it delivers the cheapest water in Southeast Asia while obtaining the best national performance in terms of leakage control, service to the user and pro-poor policies.<sup>8</sup>

The 1997 Asian financial crisis was a turning point for Malaysia's water sector. Combined with an exceptional drought caused by a strong El Niño in 1997-1998, the crisis revealed that systems were not as environmentally and economically robust as thought. This reinforced a diagnosis of decreasing surface water quality and quantity, uneven technical efficiency, indebtedness and concession contract failures, triggering a debate over broad reforms of the entire sector in the country.

## **The reform: Political ambitions and a roadmap**

The Malaysia Water Association (MWA), the country's water sector professional association, was first to push for reform of the sector; in 2001, it teamed up with federal officials from the Economic Planning Unit of the Prime Minister's Department to sug-

### Box 1 The IWK failure

Water privatisation through concession contracts became unpopular in the country because of the magnitude of the tariff increases it caused, but the disastrous experience of the *Indah Water Konsortium* (IWK) also played a role. Wastewater systems in the country were managed before 1993 by local governments and were generally in poor condition, due to the lack of investment and maintenance. IWK, a company created by one of the wealthiest businessmen of the country, Vincent Tan Chee Yioun (also reportedly a close relative of then-prime minister Mahathir Mohamad), approached the government and proposed to take over and upgrade wastewater through a national concession. The concession was awarded in 1993 without tender. IWK's legal basis for invoicing customers was unclear and refusals to pay soon spread throughout the country, endangering the financial viability of the venture and prompting the government to intervene to lower sewerage tariffs and inject hundreds of millions ringgits (1RM=US\$0.25 at 1998 rate) in long-term soft loans (while IWK's shareholders were contractually guaranteed a minimum rate of profit by the government).<sup>9</sup> The company changed owners three times in its first four years of existence, but in 2001 the government had to buy the company back from Prime Utilities, a listed Malaysian company in which Vincent Tan still owned 30% of the shares.<sup>10</sup> By then, IWK's debt amounted to RM700 million, most of it owed to the government that had lent more than RM1 billion in total to the company. The government nonetheless paid RM200 million to buy it back, a higher price than it had received from the initial concession contract deal.<sup>11</sup> The company is still managed by the minister of finance today.

gest a series of measures to the federal government.<sup>12</sup> Some were kept in the Eighth Plan (2001-2005) but in general this initial attempt was unsuccessful given the sensitivities surrounding state competencies. Nevertheless, negotiations went on with states to obtain an agreement in principle. In 2004, the newly-created Ministry of Energy, Water and Communications – water was becoming a ministry portfolio for the first time in Malaysia – launched a series of reforms to tackle challenges that had been identified by the MWA. The ministry tasked business consultancy KPMG in August 2004 to lead the consultation, with the following objectives as worded by the consultant:

- To propose a viable, low-cost industry structure for water and sewerage services in the country
- To help the Federal Government put in place a policy and regulatory framework for the orderly and sustainable development of the water services industry

- To conduct comparative studies based on other international water regulatory bodies as a guideline for the establishment of the proposed National Services Commission
- To conduct a study on amending the Federal Constitution in the event that the Federal Government takes over the regulatory function of water services from the States
- To prepare two sets of draft bills: a Water Services Industry Bill to govern the water industry, and a National Water Services Commission Bill to establish the formation of the regulatory body<sup>13</sup>

The proposed reform consisted in unifying water and wastewater services policy and regulation at the federal level, and in setting up a business model enabling an economic transition to full cost recovery as a long-term objective, a pre-condition to end the water sector dependency on uncertain funding based on political decisions. This focus on 'water services' rather than 'water' in general was already an important limitation of the response to the initial crisis diagnosis in the sense that water resource management was not included in the reform and remained the sole responsibility of states. In reality, states did not want to lose control of water catchment areas for political and economic reasons (some had profitable business activities on these lands, logging in particular). Another shortcoming of the reform was the refusal by the eastern states of Sabah and Sarawak (on Borneo island) to join the process.

Despite these concerns, reforms were set in motion with the first step being an amendment to the Federal Constitution that was passed by both houses of Parliament in January 2005, moving water supply and services from the State List of exclusive responsibilities to the shared federal-state responsibilities Concurrent List, and transferring water revenues from the states to the federal government. The only change made to water resources regulation was in the form of the creation of a National Water Resources Council, chaired by the prime minister and tasked with coordinating water resources policies at the national level.

The next steps in the reform process related to the adoption of two laws in 2006: the Water Services Industry Act (Act 655; WSIA), a comprehensive legislation providing the details of the reform, and the National Water Services Commission Act (Act 654) to set up an independent national regulator with vast monitoring and enforcement powers: the *Suruhanjaya Perkhidmatan Air Negara* (SPAN). A new public company was created under the direct authority of the Ministry of Finance, the *Pengurusan Aset Air Berhad* (PAAB), whose primary task was to facilitate fundraising for the entire national water sector at the cheapest rate possible.

The aim of the reform was to use ‘inner benefits’ of both public and private sectors, that is to say, cheap access to funding by the public sector and efficient, commercially sound service delivery by the private sector. On the one hand, PAAB would be tasked with raising funds on the market with government credit rating; on the other, it would buy all water assets in the country from existing operators (except in Sabah and Sarawak) and lease them back to these same operators afterwards. The difference was that they would then become managers of a public federal asset, would be transformed into corporations if they were not already, and would be exposed to competitive pressures (due to the short, three-year duration of the lease contracts).

It was hoped that these measures would prompt delivery of an efficient service. In theory, PAAB was expected to fund capital expenditures and the operators, operational expenses; that is, PAAB would manage major projects such as dams, plants and large development projects, be they for new assets or for their replacement, while operators would take charge of small infrastructure projects in addition to maintenance and management tasks.

One of the remarkable features of this reform was its ambition to develop a new, Malaysia-specific institutional structure for the water sector that would break free from previous models. In the words of Dato’ Sri Dr Lim Keng Yaik, minister of energy, water and telecommunications from 2004 to 2008: “The reform model that we are embarking on is unique and I hope it will serve as a guide to developing as well as developed countries.”<sup>15</sup> The current CEO of SPAN, Dato’ Teo Yen Hua, also explains the rationale behind the change in policy: “Generally, long-term privatisation concessions are not suitable for the water sector. Even the World Bank accepted this fact. There is also no one-size-fits-all solution. No one model can meet the needs of all countries.”<sup>16</sup> MWA’s President, Ahmad Zahdi Bin Jamil, gives further insight into the ambitions of the Malaysian water industry through this reform, which he says are aimed at “making Malaysia THE water hub for developing countries.”<sup>17</sup> Further, KPMG consultant Chin Yoong Kheong, who had a leading role in shaping the reform and facilitating the consultation process, also uses such a bold tone when describing the reform:

To put it simply, we have managed to carve a workable business model for an industry that is currently not at full-cost recovery (or loss making under conventional accounting) to have access to long term AAA rated bonds. Through PAAB, we have widened the breadth and increased the depth of the bond market specifically for the water services industry without undue financial burden to the Federal Government. PAAB is an initiative of a public-private partnership that leverages the strength of both the public as well as the private sector. We are entering into uncharted territory and we know we have a winning strategic plan.<sup>18</sup>



## Box 2 The National Water Services Commission

The National Water Services Commission (*Suruhanjaya Perkhidmatan Air Negara*, SPAN) was created in April 2007 to become the pivotal independent regulator in the new institutional architecture created by the 2006 water reforms in Malaysia. Between eight and 10 people sit in the Commission in addition to its (non-executive) chairperson and CEO, all appointed by the Ministry of Energy, Water and Telecommunications for a period of two years. Current members are federal government officials (3), private construction firm executives (2), business lawyers (2) and one consumer NGO representative. The Commission meets once a month.

The Commission itself leads a 149-strong administration based on 2009 figures, with four regional offices in the country and headquarters in CyberJaya, half an hour drive from Kuala Lumpur. SPAN's role is crucial in that it co-delivers (together with the Ministry of Energy, Green Technology and Water) licences and regulates all water industry professionals active in the country (water services contractors, public and private water supply operators, public and private sewerage operators and contractors, manufacturers/suppliers and even plumbers), a legal requirement compulsory since the WSIA states that anyone operating a water system without such a license will face a heavy fine, and possibly even a prison term. Crucially, SPAN is meant to design a "robust, stable and transparent framework for periodic tariffs reviews."<sup>14</sup> The current system forces operators to use industry-benchmarked costs determined by the regulator in order to keep these operators under competitive pressure. This means that tariffs are reviewed within a technical, rather than political, framework.

Water operators, public and private, must submit a business plan to get their license and sign the three-year lease contract with PAAB that allows them to operate the system. SPAN monitors them along Key Performance Indicators that look at water quality, unaccounted for water, pressure, and customer services in a benchmarking approach. SPAN's enforcement powers are important, with the legal ability to take measures as far-reaching as replacing the entire management of an operator in the event it would repeatedly not comply with its assigned targets. SPAN's monitoring also relies on direct consumer input, with an entire department tasked with receiving and handling complaints, in close cooperation with a consumer body specifically created for this purpose and funded by SPAN, the Malaysian Water Forum.

SPAN's role is essential in safeguarding public, social and environmental dimensions through monitoring of operators constituted as corporations whose only structural objectives are to at least reach financial balance within their own accounting scope. The general rationale is that operational efficiency will stem from this arms-length relationship between the regulator and the operators, and that this efficiency will be the source of legitimacy for moving toward full cost recovery.

Indeed, if the public-private partnership concept is not new, the idea to enlarge its application to an entire country in a systematic manner is unheard of. The scope of this reform and its ambition were a subject of pride for the majority of people interviewed for this research, notably consumer organisations, who are given a prominent role in dealing with customer complaints and in advising SPAN, and who insisted that the level of transparency enabled by the scheme is high, breaking with former practice in the country. Other interviewees and sources also point to the large and open consultations that took place prior to the reform in order to obtain as large a buy-in as possible from all players, and mention the fact that the two draft bills were de-classified to allow for public discussion before being voted in Parliament, a move described as unusual in Malaysia's political system. This is not to say that everyone agreed with the reforms, but the process was inclusive enough to allow the reforms to move forward.

The roadmap for the reforms was embedded within the country's five-year plans as follows:

- **Stabilisation (2001-2005):** The Eighth Plan provided for an initial step into the reform with the corporatisation of state water authorities, and oversaw the planning of the national water services industry restructuring.
- **Consolidation (2006-2010):** This plan addressed the operationalisation of SPAN, enforcement of the Water Services Industry Act (WSIA) 2006, the transfer of water-related assets to PAAB at negotiated value and the development of new water infrastructure; it also facilitated service providers becoming asset light to focus on efficiency and effectiveness.
- **Toward Efficiency (2011-2015):** This plan puts in place a tariff setting mechanism to allow full cost recovery to be completely phased in 2013, integrates water supply and sewerage services, and represents initial efforts toward the introduction of integrated water and sewerage tariffs.<sup>19</sup>

### **Reality check: Political and practical problems**

As with any reform, the real work began with implementation. It is still too early to adequately assess the outcomes, however, due to delays in the process: only five states had transferred their assets and liabilities to PAAB by mid-2011: Melaka, Negeri Sembilan, Perlis, Johor and Pulau Pinang, the latter having only signed a deal with PAAB in June 2011. According to November 2010 data provided by SPAN,<sup>20</sup> technical performance has improved for three of these states (no data was provided on Perlis), with unaccounted for water decreasing as a result of improved metering, maintenance, actions against illegal connections and billing systems efficiency, particularly in Johor where the assets were owned by the current operator, SAJ Holdings, a privatised company (subsidiary of

Malaysian water corporation Ranhill). In these three states, water coverage reached 100% in urban areas and more than 99.5% in rural areas, and tariff revenue increased.

The reform must also be seen in light of the general picture of rampant centralisation in the country. As a guarantee, state governments obtained legal protection against any private participation in PAAB or change in the nature of the land where the water systems are located, and thus any of those two occurrences would automatically trigger the return of the assets to the state governments. There is political uncertainty on the horizon, however. In terms of labour relations, the ongoing corporatisation of the public operators (achieved in Negiri Sembilan and Kedah, underway in Perlis, Pahang, Labuan and Perak) has been met with strong criticism from workers' unions, who point to low wages, degraded working conditions and fear that their companies will be privatised once corporatised and made to appear profitable. Other critics point to another weakness of this reform: the exclusion of broader water resource management issues that undermines the possibility of serious action on decreasing surface water quality and quantity.

But other elements tend to show that more fundamental flaws have developed within the model itself, and particularly at the level of the strategic assets-holding public company, PAAB. In order to obtain the funds needed to develop the infrastructure, PAAB raises money on international bond markets. Rating agencies consider that the guarantee given to PAAB by the Ministry of Finance, as well as the strategic nature of its assets, mean that PAAB's credit risk is the same as Malaysia's. PAAB can therefore access funding with an average 2.5-3% yearly interest rate, well below any Malaysian private company's fundraising possibilities. The original idea was that PAAB would act as a financial middleman, only charging the operators its overhead costs plus interest (the lease contract fee was indeed meant to be determined on an affordability principle, not directly based on the assets' value). However, it seems that the general principle changed along the way: operators are now identified by SPAN and PAAB in different categories according to their reimbursement capacities, and the lease fees are now based on a fixed share of the assets' value. The weakest operators having signed a lease contract so far were applied a 3-4% yearly rate, but the Johor operator (SAJ) has to pay a lease fee as high as 6% of the asset value (RM240 million a year for assets valued at 4.03 billion).<sup>24</sup> Such an interest level is still lower than what SAJ could obtain on the markets, but it is two times higher than what PAAB itself must repay, so the fee is obviously well above PAAB's operating costs. In sum, the intended 'cheap funding' for the water sector has turned into a money-making venture for PAAB (questioned on the issue, PAAB contends that it needs to raise its rates to meet its operating expenses<sup>25</sup>). Such an added cost to the funding of water projects is all the more striking given that state governments could apply for interest-free loans for water infrastructure development in the previous system and that this institutional

### Box 3 Water fights in Selangor

State-federal government rivalry remains very important even after the sweeping Malaysian water reform. A major political battle on water issues has been taking place in the state of Selangor, the richest and most populated state of the country that was won by the opposition political coalition *Pakatan Rakyat* in 2008. The water systems there had been gradually privatised from 1997 by the former governments. First, the profitable parts of the system (water treatment plants) were handed out to a local private company called *Puncak Niaga*, which got a lucrative concession contract to supply water to the then-public distribution company. Second, two Build-Operate-Transfer contracts were awarded for new water treatment plants, bringing three private companies on board to operate water treatment facilities in Selangor. Then, the entire distribution and billing system was corporatised and eventually privatised by the company *Syabas*, in which Puncak Niaga bought a 70% stake (the state keeping the other 30%).

In late 2008, discussions started between the opposition-led state of Selangor and the four companies to negotiate the conditions of an asset buy-back. Two companies accepted the state offer, but not Puncak Niaga nor its subsidiary. SPAN and PAAB got involved in the discussion, but very quickly the discussion turned into a bitter political fight between the Selangor state on the one hand, and PAAB/SPAN and the water corporations on the other, Selangor reproaching PAAB for valuing assets in favour of Puncak Niaga. It also accused PAAB of ideological preference toward the private sector. But some critics say the reason was political: Puncak Niaga's CEO, Tan Sri Rozali Ismail, who belongs to UMNO (the party in power at the federal level and therefore with influence over PAAB's decisions) has been the treasurer of its local Selangor section<sup>21</sup> and a likely substantial financial contributor to the party.<sup>22</sup> Meanwhile, the state refused a 37% tariff increase to Syabas, increasing these companies' debts to the extent that, in late March 2011, Syabas and Puncak Niaga's corporate bonds were downgraded by rating agencies, prompting a government intervention in June 2011 through PAAB buying these bonds and saving the companies.<sup>23</sup>

model was theoretically set up to “bridge the gap between long term sustainability and immediate need of funds.”<sup>26</sup> One interviewee suggested that this change of interest rates policy occurred in parallel with the change of prime minister in April 2009 (Najib Razak was finance minister under former prime minister Anwar Ibrahim), suggesting a new set of political priorities, but this allegation could not be corroborated by other sources.

This complicated relationship with politics can be seen in another domain of PAAB's activities. PAAB is run by executives trained in investment banking and has a limited

staff of about 80 persons, of which only 10% have engineering or other technical backgrounds. As a result, all of its infrastructure investments are done through public tenders. PAAB executives say that they have rigorous internal governance schemes that prevent privileged access and external influence, but as we have seen in the Selangor case (see Box 3) PAAB was not insulated from government pressures when contracting out services. That PAAB is a “wholly owned company under the Ministry of Finance Incorporated”<sup>27</sup> and that Malaysia has such a long track record of biased tenders (Malaysia is one of the few countries in the world where political parties own private corporations) does not serve to reassure anyone.

A last potentially serious problem lies in the division of responsibilities between PAAB and the operators for infrastructure works. Various interviewees explained that PAAB was supposed to only take on large infrastructure projects while the operators would remain in charge of the small expansion and maintenance works. However, the threshold between minor and major works is now RM1 million<sup>28</sup> (roughly US\$330,000), with a cap at RM10 million a year per operator. The consequence is that most infrastructure works will get outsourced by PAAB, which creates excellent business opportunities for private construction and engineering companies as well as consultancies but raises many questions: how will the high priority works be identified when all 11 states have to go through PAAB to secure investments? How will the works' timing be respected? To what extent is it more efficient to coordinate tenders from the capital city instead of letting local operators organise these in-house? There are no simple answers to these questions but one can already sense the risk of reproducing at the national level what the reforms intended to avoid at the local level: a heavy, technocratic, poorly accountable and inefficient institutional setup managing water assets.

For certain well-performing operators such as PBAPP (*Pulau Pinang*), the reform is counter-productive in the sense that it might increase its financing costs, will delay the implementation of large infrastructure works and considerably reduce its current managerial autonomy – PBAPP eventually signed a deal with PAAB in June 2011. The fact that the reform uniformly applies to all operators no matter their operational performance appears as one of its clear limitations. Despite SPAN's CEO statement that “there is also no one size fits all solution,” the ‘perfect model’ syndrome seems to have struck once again in Malaysia.

## Conclusion

The 2006 water sector reform in Malaysia was a bold attempt at defining a new, consistent model for the country's water sector, departing from the old privatisation-through-

concession model. It garnered considerable political attention and put water issues high on the political agenda. It is costlier than the previous system, which benefited from subsidisation of the water infrastructure through central government interest-free loans, but this is meant to be compensated by an institutional framework designed to deliver tighter controls on the way public money is used and to create a performance incentive stemming from competitive pressure to comply with a set of key performance indicators. The level of profit that operators can extract from the assets being leased to them is also meant to be closely regulated. This new framework aims to harmonise water systems throughout the country, potentially reducing discrepancies between rich and poor states and guaranteeing the application of a number of performance indicators and standards.

Central to these reforms have been ‘tariff de-politicisation’ and ‘full cost recovery’. The most immediate consequences have been moving tariff setting decision making from the local political level to a national technocratic level, from an arena where public debate and disagreement are the norm to one where consensus building is necessary, and from the criticism of opposition parties to the cooperation of consumers and NGOs. This is crucial and may have been the main motivation for the reform given the numerous complaints by private operators about state governments refusing to set water tariffs at profitable levels. The full cost recovery discourse, for its part, is a narrow attempt at insulating the water services industry from institutional politics and one sees this ideological trail throughout the reforms. The technocratic assumption is that a carefully defined governance framework can solve all the challenges of the water sector without the messy politics of debate.

Although it is too early to assess fully the outcomes of these reforms, results thus far are mixed. On the positive side, there is broader commitment to a public-led national water services strategy, a mechanism to systematically forward users’ complaints to the regulator has been set up and it appears that service coverage and technical reliability are to improve in the short and medium term due to new public capital investments. Nevertheless, cracks are beginning to show. The exclusion of water resource management issues beyond the confines of service delivery are particularly dangerous due to the larger environmental impacts of water systems, and it appears that managers will not integrate this broader dimension into their performance indicators. Moreover, chances are that corporatised water operators will try to increase their profits excessively by degrading working conditions and limiting regulatory compliance to the minimum, as typically happens in public-private partnerships.

Even more problematic is the illusory attempt at de-politicising water management: PAAB’s changes in political priorities, as well as its political ties, show that the water

sector is still influenced by politics but that these politics are no longer institutional and therefore no longer regulated by a system of checks and balances of publicly expressed interests and ideas. This places Malaysia's newly centralised 'public' water sector at the mercy of interests that would be powerful enough to influence PAAB's and SPAN's decision making, and shows that, ironically, this public intervention to solve Malaysia's feared water crisis might have weakened the country's ability to respond to it in the long run by widening the gap between open public discussion and policy making.

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## Chapter Seven

# Looking to the Future: What Next For Remunicipalisation?

by Olivier Hoedeman, Satoko Kishimoto and Martin Pigeon

This book, with its five in depth case studies, is the most comprehensive review of water remunicipalisation to date. The cases provide strong arguments for public water management as a viable alternative to privatisation. While remunicipalisation is by no means simple, each case proves that public management can offer services that privatisation could never deliver. Remunicipalisation is a credible, realistic and attractive option for citizens and policy makers dissatisfied with privatisation. The cases should be a source of hope and inspiration, but also of specific insights and lessons for anyone wanting to challenge and overturn water privatisation.

No less than 40 municipalities in France have decided to remunicipalise in the near future, including large cities such as Bordeaux and Brest. Elsewhere in Europe and the Americas the negative experiences with privatisation are making cities choose remunicipalisation too. In Africa, more and more private water contracts are not renewed. Some of the remaining Asian privatisation contracts are coming under serious pressure and there is good reason to expect the momentum for remunicipalisation to build further as the shortcomings of water privatisation become more apparent and water justice movements gain strength. A recent striking example is Napoli, in Italy, where the city council decided to remunicipalise water services as a response to the June 2011 Italian referendum on water privatisation in which 96% of voters opted to overturn the laws facilitating water privatisation in the country, one of the most significant expressions of public support ever for remunicipalisation and public water more generally.

As growing numbers of cities embark on the transition from private to public water management it is crucial to take stock of lessons learned and avoid pitfalls. This will increase the chances of successful remunicipalisation, especially where the change is not simply from private to public control but involves creating more transparent and accountable public operators securing socially and environmentally sustainable water and sanitation systems for all. Remunicipalisation struggles provide a real opportunity for citizens not

only to end privatisation but to help shape public water companies that are democratic and responsive to their needs. Remunicipalisation is not merely about returning to the pre-privatisation situation, but should be about reinventing public water management altogether.

In Paris, water delivery was successfully transferred in 2009-2010 with impressive results on many fronts, from increased transparency and cost savings to improved water resource protection. It is the largest remunicipalisation in Europe to date and was by no means a simple matter, due in part to the fact that the city's water supply was run by two private water firms, each covering half of the city. There was internal opposition among parts of the city's administration and rigid public procurement procedures created difficulties for the new public operator, but these and other problems were overcome. Thanks to remunicipalisation, the city saved approximately €35 million in its first year and was able to reduce the water tariff by 8%. The savings reflect the fact that the two private firms, Suez and Veolia, had extracted excessive profits from their private concessions. The new public operator ended the financial opacity and poor accountability that had characterised privatisation, and has demonstrated that remunicipalisation is not just about transferring ownership and management control, but also about embracing progressive water policies, improving environmental standards, enhancing international solidarity and other public interest goals. The city's public water company now works with a long-term perspective; for instance, it leads awareness-raising campaigns to promote tap water as well as public-public partnerships with water utilities in developing countries.

The transfer to public management brought very significant savings and efficiency gains in the Canadian city of Hamilton as well. Following a strong campaign by citizens' groups and unions against the secrecy and mismanagement of the private water operator, the biggest privatisation contract in North America ended with its non-renewal. Transparency in the operations of the water utility greatly improved as a result of the remunicipalisation, which also proved a genuine source of savings as it allowed the municipality to properly verify the utility's performance and make year-to-year budget adjustments. The operation was a clear success, even if some problems remain. There are concerns about the public utility becoming increasingly corporatised, which might result in the utility behaving as a private company and not being as accountable to citizens as it should be. Hamilton, moreover, suffers from major environmental challenges, including a toxic sludge disposal problem. Attempts to solve this through very expensive new investments in large-scale water technology are unlikely to bring long-term sustainability to the city's water usage. The problem of relying on large-scale, centralised infrastructure and technological fixes exists to varying degrees in all the cases covered in the book and remains a challenge for modern municipal water systems.

In terms of the number of inhabitants, the remunicipalisation in Buenos Aires was even larger than Paris. Whereas the transfer to public management in Paris happened at a time when the private contract ended, remunicipalisation in the Argentine capital started when the government terminated Suez's 30-year concession only halfway through that period. This was a tough decision to take given the legal consequences: the Argentine state was immediately sued by the company with a claim of US\$1.7 billion at the World Bank's International Centre for Settlement of Investment Disputes (ICSID), whose decision is still pending at the time of writing. The decision to end the contract came after Suez systematically failed to meet its contractual targets for expanding coverage and improving the quality of water services. The water multinational was not making the promised investments, but repeatedly called for contract renegotiations to boost profits. The new public company, owned 10% by the workers' union, has achieved impressive results in the first five years, particularly in terms of expanding coverage to citizens in poorer neighbourhoods, involving them in public works programmes and broadening access to water and sanitation. These measures were financed by public investments despite decreasing revenue. There are problems in the institutional setup, however, such as a lack of participation channels for water users at the decision-making level, as well as other legacies from the privatisation era such as an unfair tariff system. The public water company has yet to take up the ambitious challenge of securing a holistic and environmentally sustainable water management programme covering the whole water cycle, which would require solutions to the polluted water in the metropolitan river basins.

The remunicipalisation in Dar es Salaam brought about a reduction in water leakage levels and extended coverage after a short but disastrous privatisation experience. But the system is still a far cry from providing universal access to water and sanitation. Tanzania's dependency on international donors, particularly development banks, has had a defining influence on the remunicipalisation experience: the failed privatisation contract terminated by the government had been imposed by the World Bank and other development banks in the first place, and those institutions accepted the replacement of the private company by a public one but changed nothing in the previous institutional setup, and they continue to decide on the entity's priorities. This donor-controlled transition contributed to an excessive focus on increasing revenue collection and the promotion of projects that were not necessarily technically relevant. The Dar es Salaam example highlights the continued financial dependency of impoverished countries on international donor institutions that promote neoliberal water sector reforms and other blueprint approaches to local problems.

The water sector reform in Malaysia was slightly different from the other cases in this book in the sense that it occurred on a national scale. It is an attempt to harmonise

water management throughout the country after a series of disappointing concession experiences, to boost water infrastructure development in the poorest states, and to apply revised performance indicators and standards. Crucially, two central objectives of the reform were the ‘de-politicisation’ of tariff setting and the implementation of full cost recovery. Corporatisation of all water utilities is also a central element. So far, the reform has brought about mixed results. On the positive side, new public investments seem to increase service coverage and technical reliability in states where needs are greatest, and there is now an improved mechanism for user complaints to the regulator. On the negative side, there are problems such as the exclusion of water resource management issues, the likely degradation of working conditions, and the utilities’ corporatisation reducing regulatory compliance. National centralisation also reduces the flexibility of local and state water utilities to respond to local circumstances, including social needs. As for the promises of smooth economic self-regulation, a few years in this reform have already shown that the water sector is not politics-proof, that it will never be, and that the new structure is increasing risks by reducing the diversity and public service ethos of the country’s water managers.

While the cases covered in the book all show the clear benefits of remunicipalisation, there are major differences in the degree of ‘publicness’ in the new public water companies. In some cases the new systems are far more ambitiously ‘public’ in terms of commitment to the public interest and genuine accountability to citizens. In Dar es Salaam, the private operator was replaced by a new publicly owned company, but the institutional setup and the company’s priorities did not change much. In Buenos Aires, the government ensured that the new public company would focus on universalising access to water and sanitation, backed up by public investment. In Paris, the new public utility has a holistic agenda of pursuing public interest water policies, including environmental and international solidarity goals. In Paris and Buenos Aires, strong political leadership was instrumental in securing ‘publicness’ in the operations of the new water companies. In both cases, however, the mechanisms for citizen participation are underdeveloped, as are other institutional accountability mechanisms that can help keep public companies on track in terms of serving the public interest. In Dar es Salaam the power of international donor institutions closed off possible ambitions in this respect.

A clear lesson from all the cases in this book is the need to develop a clear vision of what kind of public management is to replace privatisation, including an institutional setup that can build a genuinely public water system. When done well, remunicipalisation can instill a new institutional culture in public utilities and foster better relationships with users and citizens. If poorly done it could do little to improve the ‘publicness’ of the water system.

Terminating a privatisation contract before it ends is clearly the most difficult road to remunicipalisation, compared to non-renewal after the contract expires. Such terminations give rise to complex and hard-fought political struggles, and can end in legal battles in far-away, and often corporate-friendly, dispute settlement courts. Nevertheless, the two termination cases in this book, Buenos Aires and Dar es Salaam, demonstrate that dissolution of privatisation contracts is feasible if the political will exists.

These efforts provide hope for other cities, such as Jakarta, Indonesia, where one of the most intense battles over remunicipalisation is currently taking place. In Jakarta, water multinational Suez has had a privatisation contract since 1997 that runs until 2022. Suez has failed to fulfil its obligations to extend and improve water supply to the city's inhabitants, water users are overcharged and the company secures excessive profits. Although there is broad political consensus that private provision does not work, real change proves extremely difficult to achieve due to the penalties that are likely to follow from a court case if the city ends Suez's concession. Meanwhile, the flaws in the contract and the multinational company's high ground create a power imbalance that leaves public authorities unable to force a step-up in its performance and to limit profit margins. Any renegotiation of the contract signed during the Suharto dictatorship is left to the company's good will. The Jakarta experience should serve as a warning against privatisation contracts that severely limit the political space and choices available to citizens.

Another important lesson is that any remunicipalisation effort should try and pre-empt pitfalls before the transition starts. The citizens' movement for remunicipalisation in Hamilton, for example, dedicated considerable attention to technical issues, both in terms of analysing the shortcomings of privatisation and in choosing strategic targets for their campaign. The groundwork was essential to prepare a successful transition.

Other options such as public-public partnerships (PuPs) are extremely useful in campaigning for remunicipalisation. The Dar es Salaam example, despite its limitations, features an interesting case of how not-for-profit partnerships with other public utilities can be used to mobilise technical and management expertise for improved public water supply at home. PuPs are increasingly popular because they can bring practical improvements without the disastrous loss of local control that happens with privatisation. Since 2006, the United Nations has actively supported such partnerships, which has led to the creation of the Global Water Operators' Partnership Alliance (GWOPA) coordinated by UN-Habitat. A growing number of European public water utilities now engage in solidarity-based international partnerships, such as the public water companies of Paris and Amsterdam and that of the Seville province, Spain.

Closer cooperation between public utilities has a key role to play. Cities embarking on remunicipalisation could benefit tremendously from the experience of public water opera-

tors that have successfully gone through this transformation. An international network of remunicipalised water operators would be ideal, perhaps as part of a future global network of public water companies. Civil society, trade unions and academic researchers also have a crucial role to play in international exchange of expertise on how to achieve transparent, accountable and effective public water management.

International solidarity also helps create a more supportive environment for public water. Currently, remunicipalisation processes happen with virtually no official political, technical and financial support. Many government agencies, international financial and donor institutions, and mainstream water sector organisations either favour a strong role for the private sector, crossing out remunicipalisation altogether, or have not yet realised the importance of the remunicipalisation trend.

The Dar es Salaam case is interesting in that it shows how the constraints imposed by international donors are an obstacle to successful remunicipalisation. The interference of the World Bank silenced any real debate about what public water model could best solve the city's water problems and imposed a neoliberal model limiting changes to management practices. Donors also pushed for infrastructure projects that were not necessarily appropriate. This experience demonstrates that international political and financial support to enable developing countries to choose and locally develop progressive public water management is still lacking. The World Bank stubbornly continues to seek new ways of commodifying and privatising water and limits its recommendations to public utilities to ways in which they can corporatise their services. Civil society campaigns to reform international development banks and to create alternatives to these institutions are therefore of utmost importance.

Whereas the global wave of privatisation that peaked in the late 1990s lost strength because of numerous failures around the world, a revival might now be taking shape. The deep economic crisis that has developed after the collapse of financial markets in 2008 is creating a new and entirely unjustified momentum for privatisation. This is particularly the case in Europe, where the crisis is intensifying because of austerity policies imposed in many countries, with European Union (EU) institutions driving these changes. Harsh budget cuts and privatisations are presented as necessary for growth opportunities and to regain the trust of financial markets, even though this deepens the recession in the real economy. Among the most alarming examples of this ideologically-driven and irresponsible privatisation push is Greece, where the administrative takeover by the EU and the International Monetary Fund (IMF) in return for new loans is now imposing the privatisation of water utilities in large cities such as Athens and Thessalonica. Encouragingly, the sell-off of large parts of the shares of these companies to private interests is opposed by citizen groups, who are developing creative counter-strategies.

In the Greek city of Thessalonica, a coalition of citizens' groups called *Initiative 136* is creating a new organisation to compete with Suez in the tender for the acquisition of the shares and the management of Thessalonica's Water and Sewerage Company. The dual goal is to prevent privatisation and replace the model of state administration that has failed to protect the public character of water resources and infrastructure, and secure genuine democratic control of the city's water by its citizens. The management would be organised through local cooperatives, with citizen participation. *Initiative 136* is an effort to pre-empt privatisation before it is implemented, with an attractive concrete alternative in the form of improved public management. It is a truly inspiring reflection of the growing strength and awareness of the water justice networks to see a water remunicipalisation campaign emerge even before privatisation is implemented.

As the first collection dedicated to the topic of remunicipalisation, this book cannot answer all the questions that are raised by this trend. We simply hope the book will spark additional research and further debate on these matters.



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## Get Involved!

**Corporate Europe Observatory (CEO)** is a Brussels-based research and campaign group working to expose and challenge the privileged access and influence enjoyed by corporations and their lobby groups in policy making. CEO works in close alliance with public interest groups and social movements in and outside Europe to develop alternatives to the dominance of corporate power. CEO has worked for many years on promoting alternatives to water privatisation. [www.corporateeurope.org](http://www.corporateeurope.org)

The **Municipal Services Project (MSP)** explores alternatives to privatization in the health, water, sanitation and electricity sectors. The MSP is an inter-disciplinary project made up of academics, labour unions, non-governmental organizations, social movements and activists from around the globe. Our website offers an interactive platform for researchers and others from around the world to engage in discussions on this topic. [www.municipalservicesproject.org](http://www.municipalservicesproject.org)

Founded in 1974, the **Transnational Institute (TNI)** is an international network of activist scholars committed to critical analyses of the global problems of today and tomorrow. TNI seeks to create and promote international co-operation in analyzing and finding possible solutions to such global problems as militarism and conflict, poverty and marginalisation, social injustice and environmental degradation. TNI serves as the coordinating hub of the Reclaiming Public Water (RPW) network. [www.tni.org](http://www.tni.org)

The **Reclaiming Public Water (RPW)** network promotes people-centred and democratic public management in order to make the human right to water a practical reality for everyone. RPW is an open and horizontal network connecting civil society campaigners, trade unionists, researchers, community water associations and public water operators from around the world. [www.waterjustice.org](http://www.waterjustice.org)

The **Remunicipalisation Tracker** website aims to increase the visibility of the remunicipalisation trend by showcasing cities, regions and countries that have rolled back privatisation and embarked on securing public water for all that need it. New examples are added and existing cases updated regularly, with the support of water campaigners, public water utility managers, trade unionists and others committed to successful remunicipalisation. [www.remunicipalisation.org](http://www.remunicipalisation.org)

# Index

## A

AASA (Aguas Argentinas SA) 59, 61-4, 66-8, 70-3  
accountability 14, 79, 85-6, 107, 109  
activists 21  
Agua y Saneamientos Argentinos *see* AySA  
Aguas Argentinas SA *see* AASA  
Amsterdam 110  
Anglian Water Limited 72  
Argentina 8, 11, 59, 63-4, 70-2  
AWW (American Water Works) 79-80, 82  
AySA (Agua y Saneamientos Argentinos) 59, 64-73

## B

Bertrand Delanoë 28, 39  
billing system 44, 51, 100  
Bewater 41, 43, 45  
Bewater-Gauff 45  
Buenos Aires 8, 10, 13, 15-16, 59, 66-7, 69-72, 108-9

## C

Caisse des Dépôts et Consignations (CDC) 27, 30  
Canada 8, 75, 77, 80  
Canadian Council for Public-Private Partnership (CCPPP) 89  
Canadian Union of Public Employees *see* CUPE  
CCPPP (Canadian Council for Public-Private Partnership) 89  
CDC (Caisse des Dépôts et Consignations) 27, 30  
citizens 16, 21, 79, 81, 86-7, 92, 106-10, 112  
civil society water assembly 36  
competition 9, 18, 35, 91  
concession contracts 43, 61, 94  
contract renegotiations 35, 60, 62, 68, 108  
conflictive process of 59, 63

cooperatives 69  
corporatisation 18, 26, 87, 98-9, 109  
cost recovery 54-5, 87, 95, 97-8  
costs 35, 48, 68-9, 71, 78, 82-3, 85, 93, 99  
cross-subsidisation 18  
CUPE (Canadian Union of Public Employees) 22, 81, 88-9  
CWS (City Water Services) 41, 43-5, 50

## D

DAWASA 42-5, 50-1, 54-5, 57  
DAWASCO 19, 41, 46, 48, 50-1, 53-4, 56-7  
development agencies 52-3  
development banks 108  
donor conditionality 55-6  
donors, international 18, 41, 53-4, 108, 111  
drinking water 26-7, 35, 66, 76

## E

efficiency 12-14, 65-6, 87, 93, 97-8, 103  
electricity 20-1, 32, 78, 87  
energy 48, 85, 94, 96-7  
engineers 49  
environmental protection 59, 61-2  
equity 12, 14, 19, 67  
Europe 16, 106-7, 111  
European federation of public water operators 36  
European public water utilities 110  
European Union (EU) 111

## F

farmers 35, 85  
finance 8, 21, 33, 57, 94-5, 99  
financial opacity 28, 107  
Foreign water specialists 53  
France 8, 25-6, 28, 33, 35, 63, 106  
French companies 25, 43  
frontline workers 14-15, 20

## G

Global Water Operators Partnership Alliance (GWOPA) 22, 110

Global Water Summit 103

Great Lakes 75-6

Greek city of Thessalonica 112

Grenoble 31

groundwater 26, 35

GWOPA (Global Water Operators Partnership Alliance) 22, 110

## H

Hamilton 8, 10-11, 13, 16, 75-81, 83-5, 87-9, 107, 110

Hamilton City Council 80

Hamilton Harbour 78-80, 84

Hamilton Water Watch Committee 81-2

Horizon Utilities Corporation (HUC) 87

households 36, 47, 68

low-income 8, 18-19

HUC (Horizon Utilities Corporation) 87

## I

ICSID (International Centre for Settlement of Investment Disputes) 45, 54, 63-4, 71-3, 108

illegal connections 47-8, 98

IMF (International Monetary Fund) 63, 111

Indah Water Konsortium (IWK) 94

infrastructure 35, 37, 50, 66, 68, 77, 80, 99, 103, 112

infrastructure funding 47-8

International Centre for Settlement of Investment Disputes *see* ICSID

International Monetary Fund (IMF) 63, 111

International Union of Operating Engineers (IUOE) 88

investments 13, 28, 35, 49, 60-3, 65-7, 77, 83-4, 94, 101

IUOE (International Union of Operating Engineers) 88-9

IWK (Indah Water Konsortium) 94

## J

Jakarta 110

## K

Keynesian-era water services 19

Kuala Lumpur 92, 97, 103-4

## L

labour 22, 68-9

Lake Ontario 75

leaks 46, 48

lease contract 43-5, 51, 96, 99

lease fee 45, 50, 99

local governments 9, 71, 94

London 9

Low price elasticity 62

## M

maintenance 28, 35, 42, 48, 54, 63, 66, 75, 77, 93-4, 96, 98

Malaysia 10-11, 13, 16, 91-2, 94, 96-9, 101, 103, 108

Malaysia Water Association (MWA) 93-4

Malaysian Water Forum 97

Malaysian water reforms 100

managers 14, 19-21, 25, 31-2, 51, 53, 76, 80, 85, 96, 102

markets, financial 79, 111

MCC (Millennium Challenge Corporation) 52-4, 57

Millennium Challenge Corporation *see* MCC

MINPLAN 65

municipalities 9-13, 17, 28, 31, 33, 61, 69, 77, 85, 106-7

MWA (Malaysia Water Association) 93-4

## N

National Entity for Sanitation Water Works 67

national governments 16, 48, 59, 66-7, 70-1

National Urban Water Authority (NUWA) 42

National Water and Sewerage Corporation (NWSC) 49  
National Water Resources Council 95  
National Water Services Commission 97  
neighbourhoods 36, 46, 51, 86, 108  
neoliberalism 9, 12, 18-19, 51, 59, 70-1, 73, 108, 111  
non-governmental organisations 11, 20, 59  
NUWA (National Urban Water Authority) 42  
NWSC (National Water and Sewerage Corporation) 49  
Nyerere, Julius 41, 55

## O

obligations, contractual 45, 59, 63, 70  
operational expenses 48, 51, 96  
outsourcing 32-3, 77

## P

PAAB (Pengurusan Aset Air Berhad) 95-102, 104  
Paris 8, 10-11, 13, 15-16, 25-39, 103, 107-10  
Paris City Council 25, 30  
Paris contract 31  
Paris mayor 30  
participation 14, 36-7, 65  
partnerships 35-6, 84, 110  
PBAPP (Perbadanan Bekalan Air Pulau Pinang) 93, 101  
Pengurusan Aset Air Berhad *see* PAAB  
Perbadanan Bekalan Air Pulau Pinang (PBAPP) 93, 101  
performance 12, 30, 43, 46, 50-1, 55, 59, 61-2, 65, 67, 70-1, 78, 83, 85, 110  
performance contract 33, 50  
performance fees 83  
performance indicators 43, 49, 102  
Philip Utilities Management Corporation *see* PUMC  
Phnom Penh Water Supply Authority (PPWSA) 39  
politicians 14, 16, 20, 29

pollution 60-1, 76, 92  
power 10, 41, 109  
PPIAF (Public-Private Infrastructure Advisory Facility) 21  
PPWSA (Phnom Penh Water Supply Authority) 39  
prices 9-10, 14, 47, 55, 94  
PriceWaterhouseCoopers 56  
private contract 19, 55, 59, 108  
private operators 30-2, 37, 43, 50, 54, 59-60, 62-4, 71, 75, 80-3, 85, 93, 102, 109  
privatisation 9-20, 27, 33, 42-3, 53, 59, 63, 68-72, 75, 81, 87-8, 103, 106-7, 109-12  
privatisation contracts 29, 48, 107, 110  
failed 108  
terminate 71  
privatised companies 63, 70, 98  
profit rate 26, 62, 66  
profits 10, 16, 27, 29, 34, 44, 62, 67, 78, 85, 87, 94, 102, 108  
public control 8, 71, 83, 91, 106  
public ethos 12, 14, 18, 87  
public investments 108-9  
public management 77, 83, 87-8, 106-9  
public ownership 13-14, 17, 21, 25, 35, 50, 87  
Public-Private Infrastructure Advisory Facility (PPIAF) 21  
public-public partnerships (PuPs) 110  
public sector 8, 18-20, 33, 59, 96  
public sector unions 20  
public services 12, 15, 18-19, 21, 33, 86-8  
public utilities 70-1, 104, 107, 109-11  
public water companies 107-8, 110-11  
public water management 13, 30, 36, 106-7  
publicness 15, 87-8, 109  
PUMC (Philip Utilities Management Corporation) 75, 77-80, 88-9  
Puncak Niaga 100

## Q

quality 14, 51, 60, 66, 68, 78, 80, 85, 89, 108

## R

raw water 46, 70  
Reclaiming Public Water Network 11  
regulator 65, 68, 97, 102, 109  
reliability 46-7, 51  
renationalisation 59, 64, 72  
revenue 18, 46-8, 51, 55, 64, 67  
revenue collection 44, 48, 50  
Ruvu River 42, 46, 48, 53

## S

Sabah 95-6  
SAGEP 27-30, 39  
sanitation 11, 28, 34, 36, 42, 59, 64, 72, 108-9  
Sarawak 95-6  
Saur 43  
SEGBATOS 59, 69-70  
Selangor state 100  
service cut-offs 9, 11  
sewerage 60, 62, 66, 69  
sewers 26, 84-5  
shareholders 29, 45, 63-4, 72  
sludge 85  
social movements 20, 92  
Social Tariff 68  
solidarity 12, 14, 36, 67, 85  
solidarity programs 36, 86  
SPAN (Suruhanjaya Perkhidmatan Air Negara) 95, 97-100  
state governments 93, 99, 102  
state intervention 63-4  
state water utilities 109  
Suez 29, 32, 34, 37, 71-2, 107-8, 110, 112  
Suruhanjaya Perkhidmatan Air Negara *see* SPAN  
sustainability 14, 26, 37, 55  
sustainable water management programme 108

## T

Tanzania 7-8, 11, 41-3, 45, 47, 49, 51, 53-7  
government of 41, 43, 45, 53-4

tap water 36, 107  
tariffs 44, 47, 54, 59-63, 67-8, 93-4, 97, 100  
Thames Water 80  
transparency 12, 14, 34, 36, 85-6, 98, 107

## U

UMNO (United Malays National Organisation) 91, 100  
UNCITRAL (United Nations Commission on International Trade Law) 45, 54, 72  
unions 20, 32, 37, 44, 59, 64, 69-70, 77, 88, 99, 107-8  
United Malays National Organisation (UMNO) 91, 100  
United Nations Commission on International Trade Law (UNCITRAL) 45, 54, 72  
United States 8, 43-4, 46-8, 50-3, 62-4, 66-8, 71, 79, 94, 101, 108  
universalisation 60, 66, 69, 71-2  
US-Canada Water Quality Agreement 76

## V

Veolia 25-6, 29, 32, 34, 37, 43, 80, 82, 107

## W

waste management 20-1  
wastewater 76, 84  
Wastewater Technology Centre 77  
wastewater treatment 26, 60, 84  
water bills 48, 86  
water commodification 8  
water contamination 81  
water infrastructure 84, 92, 102  
water quality 35-6, 48, 75, 92, 97  
water tariffs 25-8, 34, 54, 93, 107  
watersheds 16  
workers 8, 14-15, 25, 32-3, 59, 64, 69-70, 83, 99, 108  
workforce 44, 75, 78-80  
World Bank 8, 18, 41, 43, 45, 50-1, 53, 63, 96, 108, 111  
WSIA (Water Services Industry Act) 95, 97-8



Cities worldwide are experiencing the failures of water privatisation. Unequal access, broken promises, environmental hazards and scandalous profit margins are prompting municipalities to take back control of this essential service. Water 'remunicipalisation' is a new, exciting trend that this book explores at length. Case studies analyse the transition from private to public water provision in Paris, Dar es Salaam, Buenos Aires and Hamilton, as well as look at a national-level experiment in Malaysia. The journey toward better public water illustrates the benefits and challenges of municipal ownership, while at the same time underlining the stranglehold of international financial institutions and the legacies of corporate control. The book situates these developments within larger debates about 'alternatives to privatisation' and draws lessons from these experiences for future action in favour of public services. It is a must-read for policy makers and activists looking for concrete ways to democratise water services.

“ *Cities have been remunicipalising water for years, but finally we have a book that gives us a global perspective on this trend. It offers rich evidence of how public service providers outperform private water companies while at the same time pointing to the challenges that managers, policy makers and activists face in making water public again.* ”  
Maude Barlow, Chairperson of the Council of Canadians

