Private sector participation in water utilities has been declining in recent years raising concerns about the long term efficacy of the PSP model. These are issues that merit viable solutions as many parts of the world still lack basic sanitation facilities and access to safe drinking water.

The French concession model, whereby water utilities provide water and sanitation services under long-term concession contracts is considered to be a suitable model for addressing funding shortfalls required to provide basic sanitation and water services in many parts of the developing world. Jakarta and Manila adopted the French model in the 1990s. While Manila’s service parameters improved at many levels, Jakarta’s privatisation attempt has been marred by massive losses and inadequate service. Why did the two cities have such vastly different experiences? This policy brief attempts to decode the defining characteristics that allow for successful application of the French model.

The dominant models for Private Sector Participation (PSP) for water and sanitation have emerged from developed countries such as Britain and France. France, in particular, has a long-standing history of experiences with concession models (whereby water services are provided under long-term concession contracts) and is currently the global leader for PSP in the water sector. Private companies provide three-fourths of the country’s population with water and almost half with sewerage services and water companies from France have been actively involved in PSP projects in the water sector in many developing countries. Thus the French model is often considered when implementing water privatisation projects in developing countries.

Two major Asian cities, Jakarta and Manila, adopted the French concession model in the 1990s to deal with water provision challenges. There were considerable differences in the implementation model and likewise the privatisation produced vastly different results.

In 1997 the Jakarta government signed a contract with two private operators to operate the utility and distribute water for 25 years. The initial investment was $318 million for expanding the pipe network and meeting certain service standards. The model failed; the city’s water utility has been suffering from massive losses and coverage has been inadequate. In fact,
certain service parameters are worse than before the city’s water utility was privatised.

The Manila water public utility, the Metropolitan Waterworks and Sewerage System (MWSS) was also struggling to meet the demands of a growing population in the nineties. MWSS was privatised in 1997 and the government awarded service contracts to two companies for 25 years. By 2011 water service coverage had increased to almost full coverage in the city, despite the fact that the population of Manila increased by 25% in the same period.

Summary of Findings

Application of French Model in Jakarta

Initially the Jakarta privatisation contract was meant to be “self-regulated” buoyed by the belief that no separate regulatory authority would be required. The principle of ‘minimum government’ follows the spirit of the French model. Any disagreements between the government and the private operators could be resolved through legal terms stated in the contract. Therefore no regulatory authority was established initially but one was created (post Suharato’s regime and the financial crisis), four years after the initial contracts were signed.

There were two main deviations from the French model. One, the contracts were given out without competitive bidding. This deprived the privatisation attempt of the benefits that can accrue from the competitive tender process, and led to accusations of alleged nepotism and crony capitalism. Two, a water charge, as different from a water tariff, was introduced. The water charge is the unit cost (per cubic meter) of providing water, factoring in the cost recovery and the required rate of return. As the contracts were not awarded through a bidding process, the water charge and tariffs had the burden of making up for a potentially excessive IRR (22% for the duration of the contract).

The privatisation ran into trouble almost immediately. The gap between the water charge and the water tariff has consistently ballooned and the newly-created regulatory authority, Jakarta Water Supply Regulatory Body (JWSRB), did not have the required independence to stall the losses by increasing the water tariffs. The Governor of Jakarta often ruled against rate increases due to political reasons. As a result PAM Jaya and the local government will have accumulated a staggering Rp 18.2 trillion in debt if the contracts were to continue unmodified until 2022.

Jakarta’s water prices are one of the highest in Asia and coverage continues to be poor; only 43% of the city is covered by the water utility.

Application of the French Model in Manila

In 1997 Manila signed the largest PSP deal in the world for provision of water services, and the government corporation MWSS handed out service contracts to two private operators for 25 years.

Manila’s key deviation from the French model was that a Regulatory Office set up upfront (RO) as part of the concession agreements. The government made a choice between setting up an entirely independent regulator through a legislative process which would take longer and potentially stall the privatisation attempt and setting up a RO immediately, and chose the latter. The RO performed
fairly routine tasks of monitoring all aspects of the concession agreements. Although the RO was not entirely an independent entity, yet it was a crucial factor in the success of the PSP model.

Unlike Jakarta which attempted to create a regulatory authority mid-way, in Manila the RO protected the principles as laid down in the concession contracts from the very beginning. In one instance, Manila Water, one of the two private entities, requested a tariff rate increase a year after the contracts were signed and RO argued against the extent of the tariff hike being asked for. In another instance the RO contested the extent of the tariff hike by Maynilad (one of the private sector utilities) in a rate rebasing exercise. The refusal was on the grounds that the private operator’s operations were grossly inefficient and therefore underserving of the rate hike.

The MWSS service area was divided into two zones. This split allowed comparisons of efficiency and benchmarking between the two private utilities servicing the two zones within Manila. Thus when the RO argued against Maynilad’s inefficient operations it had a strong comparison with Manila Water to make its case. On the other hand, the significant increases allowed to Manila Water allowed the utility to plough back funds into service expansion and reduce NRW in its zone.

Policy Implications

Developing countries utilities often lack the financing capability for the extent of water and sanitation service provision required in these countries. Given this reality, and that millions of people lack access to safe drinking water, it is important that policy makers find ways to create more credible models of private sector participation in the sector.

One of the dominant forms of PSP models has emerged from France – the concession model -- and will likely be one of the most enduring models for PSP in developing countries due to the large requirements for capital investments in these markets. Therefore, the PSP model’s application in two Asian cities, Jakarta and Manila, provides useful insights for policy-makers seeking to supplant the model elsewhere.

• The success or failure of the model will depend a great deal on the nature of the modifications made when transferring the model to a new setting. Developing countries, where such PSP contracts are most needed, can be particularly challenging environments for privatisation. The environment can be exacerbated by significant information gaps, for instance about the condition of the water utilities.

• As is evident in Jakarta’s case, the pure version of the French model i.e not creating a separate regulatory authority to monitor the contracts may not be advisable. Given the environment and the circumstances of the privatisation, policy-makers must make prudent decisions on whether it merits a creation of a separate regulatory authority. This is particularly relevant in developing countries where the business environment may suffer from weakness of law and could be opportunistic and corrupt.

• One of the essential characteristics of the French model is “competition for market” when issuing the initial contracts and then renewing them. Jakarta did not follow this one step in its
privatisation process which led to catastrophic ramifications of alleged corruption and nepotism creeping into the privatisation attempt.

- It is important that the regulatory authority be given adequate powers to exercise control over factors such as tariff rise decisions; pushing utilities to be efficient operators as well as curtail opportunistic behaviours. The RO in Manila’s case was not an entirely independent legal entity but importantly had *adequate* discretionary powers to over-rule and monitor the principles of the concession contracts and even over-rule or question the extent of tariff adjustment requests.

- It is important that adequate Key Performance Indicators (KPIs) and other operational efficiency measures be laid out upfront in the concession contracts. This allows the government to monitor the performance of the private utilities (concessionaires) continuously and avoid unnecessary disagreements at the time of the tariff re-basing exercises.

The Institute of Water Policy is a research center associated with the Lee Kuan Yew School of Public Policy at the National University of Singapore. Our mission is to enhance understanding of the social and economic dimensions of policies and programs implemented to improve water management.

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