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# Water and Sanitation Utilities in the Global South: Re-centering the Debate on “Efficiency”

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## Abstract

This paper assesses the ideological arguments that sustain the belief that the private sector is more efficient than the public, which persist despite ambiguous empirical evidence. It argues that the privatization agenda rests on normative assumptions about “economic efficiency” that fail to adequately address the social goals of water and sanitation provision. The debate on “efficiency” should therefore be re-centered to consider “social efficiency” and the negative effect that privatization has on citizenship rights.

**JEL codes:** A13, N70, Q25

## Keywords

privatization, efficiency, developing countries, urban water supply, unions

At the heart of the World Bank’s drive for privatization<sup>1</sup> in the water and sanitation (W&S) sector is the argument that the main barrier preventing efficient service delivery in “weak” states in the South is the corruption and inefficiency of the public sector. The picture of the public sector that emerges in various World Bank reports is that it is overstuffed, manipulated by politicians to serve short-term political ends, and—particularly in low-income settings—inclined to provide subsidized services to the urban middle class, which leaves the urban and rural poor under-serviced (see, for example, World Bank 2004).

The World Bank’s argument is powerful because it captures a partial truth. With few exceptions, public utilities in the poor countries of the South have failed to extend universal access to W&S services. It has been estimated, for example, that 1.2 billion people lack access to safe

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<sup>1</sup>In this paper, the term privatization encompasses a spectrum of contractual arrangements between the government and the profit-seeking private sector, ranging from a management contract through to divestiture (i.e. ownership transfer). Privatization in the form of delegation to non-profit organizations is not considered. On the different forms of privatization, see Budds and McGranahan (2003).

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water and 2.4 billion lack sanitary sewerage worldwide, the vast majority of which live in the global South (Winpenny 2003: 2). Since more than 90 percent of the world's population is currently served by publicly-owned water utilities, it is undeniable that reform of the local state and public utilities is required in order to extend services (World Bank 2004: 167).<sup>2</sup>

It does not follow, however, that introducing private operators, particularly powerful multinational corporations, is the answer to poorly performing public utilities. After a wave of privatization in the poor countries of the global South in the 1990s, large multinational water companies have begun to withdraw from the W&S sector in Asia and Latin America, where currency devaluations and social mobilizations have led to a series of renegotiated and cancelled contracts. As the growing critical literature on privatization confirms, the private sector has failed to achieve the scale or the results expected (see, *inter alia*, Bakker 2003; Bayliss and Fine 2007; Hall and Lobina 2006; Hall and Lobina 2007; McDonald and Ruiters 2005; Sjölander Holland 2005). In light of the failure of the policy of privatization to achieve its stated goals, there is a pressing need to reconsider alternative modes of service delivery for W&S services.

This paper aims to contribute to this task by reviewing the argument that the private sector is more "efficient" than the public sector. It is supposed that private companies have demonstrated their superiority in performance, and that this reflects the superiority of markets over bureaucracies under political control. On the basis of these assumptions, much current debate about policy in infrastructure and services has assumed that achieving private sector operation is an objective in itself. This paper does not review the econometric evidence on the relative performance of public versus private sector utilities. Rather, my goal is to assess the ideological arguments that sustain the belief that the private sector is more efficient than the public, which persist despite lack of robust empirical evidence.<sup>3</sup> I argue that the privatization agenda rests on highly normative assumptions about "economic efficiency" based upon neoliberal conceptions about politics and the economy that fail to adequately address the social and welfare goals of W&S provision. I argue that the debate on efficiency should therefore be re-centered to consider "social efficiency" and the negative effect that privatization has on citizenship rights.

The paper is organized as follows. Part 1 introduces the policy problem. Part 2 assesses the contending ideological perspectives in the privatization debate. Parts 3 through 5 analyze three key neoliberal arguments about public sector inefficiency that pervade the academic and policy literature and present the alternative conception of "social efficiency."

## 1. The Policy Problem in the Global South

The "water problem" in global South countries refers to the fact that W&S networks have nearly universally failed to reach the poor. Poor public sector management practices combined with high rates of urban growth and limited access to capital led to the "three lows" that are often associated with public services: low rates of cost-recovery, low productivity, and ultimately low service quality and coverage (Bakker 2003; Komives 2001). Despite substantial aid and loans from international financial institutions (IFIs), most public W&S have failed to achieve universal coverage for urban citizens (UN-HABITAT 2003).

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<sup>2</sup>As several scholars have argued, part of this deficit is related to the austerity policies associated with structural adjustment. The performance of many public utilities has declined since the neoliberal era due to systematic under-investment (Gilbert 1990; Hall and Lobina 2006).

<sup>3</sup>Econometric studies that compare performance of public and private W&S agencies are inconclusive. For reviews of this literature in both developed and developing country contexts, see, *inter alia*, Estache and Rossi (2002), Warner and Hefetz (2002), Davis (2005), Trujillo and Estache (2005), and Hall (2001).

In the era of neoliberal globalization, the problem appears to be growing worse. As the provocative title of Mike Davis's (2006) recent book suggests, we live on a "Planet of Slums" and more than one-sixth of humanity lives in their own waste without access to potable water. The era of globalization has been characterized by a number of trends that have exacerbated the problem: skyrocketing urban growth due to rural-urban migration; budget austerity which reduced public investment in basic infrastructure; and increasing income polarization which means that more people have less money to pay for services (Chossudovsky 2003; Davis 2006; ILO 2004).

While there is universal agreement that the situation is disgraceful, there is a fierce ideological debate on what has caused the problem and how it should be fixed. When neoliberalism became the reigning orthodoxy in policy making circles in the early 1980s, the debate became polarized between two positions: those who promoted privatization and those who defended democratic forms of ownership and control.

On one side, the promoters of privatization include neoliberal economists and policymakers from Western governments, including bilateral aid agencies such as the United Kingdom's Department for International Development (DFID), the Canadian International Development Agency (CIDA), Germany's Agency for Technical Cooperation (GTZ), and the United States Agency for International Development (USAID); international financial institutions, particularly the International Monetary Fund (IMF), the World Bank, and the regional development banks; as well as the many lobby groups that represent the interests of private corporations in the water industry.<sup>4</sup>

Promoters of privatization argued that the main reason that W&S utilities in the Third World have failed to achieve universal coverage is because public sector managers are inherently inefficient and often corrupt. Public sector officials, they say, have failed to charge the "true market price" for water because of political reasons: wealthy people, their primary constituents, live in the center of cities and resist price hikes. The fact that water utilities have "undercharged" for water is seen as neither economically efficient nor equitable since it is usually only the relatively affluent population that has access to formal water services (Noll 2002; Shirley 2002). It is a public health concern because the poorest of the poor are left to fend for themselves, often resorting to unsafe water sources. According to the promoters of privatization, the fastest way to reform ailing public utilities is to bring in a private company which will streamline operations and raise water rates to reflect the "true value" of water and bring in new sources of finance. If the production and distribution of water is managed according to the "logic of the market," it will encourage the conservation of a scarce resource and generate the financing needed to expand formal water networks.

On the other side of the debate, opponents of privatization, herein defined as the "water justice movement," include labor organizations such as the Canadian Union of Public Employees (CUPE) and Public Services International (PSI), and international non-governmental organizations such as Food and Water Watch (formerly a branch of Public Citizen), Friends of the Earth, the Transnational Institute, the Council of Canadians, the Polaris Institute, the Mitterand Foundation, and more recently some agencies related to the United Nations, have defended public forms of provision.<sup>5</sup>

These opponents of privatization argue that multinational water companies may be effective at allocating resources efficiently, but for their own purposes, that is, to make a profit. Private

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<sup>4</sup>These international lobby groups include the World Water Council, the World Business Council for Sustainable Development, the International Chamber of Commerce, Business Action for Water, and the World Economic Forum (PSIRU 2002).

<sup>5</sup>The appointment of Canadian anti-privatization activist Maude Barlow as the senior water advisor to the United Nations's president in November 2008 is an indication of this shift.

companies are not “efficient” in an integral sense of the concept because they charge the poor more than they can afford to pay (and cut them off when they cannot afford to pay), lay off workers or pay them less for the same work, cut corners to save costs, create health and safety risks for the public, and exclude some communities from their services altogether. Furthermore, environmental damage caused by the activities of private water companies is considered an “externality,” and the public sector is left to clean up the mess. The time horizon of private companies is also shorter than that required for sustainable management. Privatization, according to this view, can exacerbate rather than solve the problem of corruption since companies often use bribes to obtain contracts.

At the root of this debate on “efficiency” lie different notions about the appropriate role of the state and the private sector (including multinational corporations and international trade regimes) in meeting economic development and equity objectives within rich and poor nations alike, to which we turn next.

## 2. Efficiency and Social Citizenship

In economics, efficiency is defined as a resource allocation that results in maximized net benefits from the use of the resource. In practical applications, the notion refers to “cost-benefit” analyses that attempt to determine the net balance between positive and negative effects of any economic act, event, or institution. If the net positive effects outweigh the negative effects, the act, event, or institution is said to be “efficient.” If the net negative effects outweigh the positive effects, the act, event, or institution is said to be “inefficient.”

Despite the pretence amongst many economists that efficiency calculations are value-neutral and irrefutable calculations, critical scholars have observed that efficiency calculations are based upon assumptions of what constitutes the “good society” (Lefebvre and Vietorisz 2007; Tverdek 2004; Wolff 2002). As these progressive economists point out, since notions of the “good society” are highly subjective, there can be no single standard of efficiency. For example, while a neoclassical economist may contend that the goal of economic production is to maximize wealth with a given resource base and judge oil production “efficient,” an ecologist may argue that the damage to the environment does not justify the means and that oil production is therefore not “efficient” (Tverdek 2004). The central point is that the selection of variables by which “efficiency” is assessed is the terrain of social struggle (Wolff 2002). Louis Lefebvre and Thomas Vietorisz echo this point when they argue that “the pursuit of efficiency calls for specifying the ultimate ends of economic activities or policies” (2007: 140). With respect to assessing the efficiency of W&S agencies, it is relevant to ask about the different ends of private and public institutions. Indeed, one of the reasons that there is little agreement amongst economists about whether public or private W&S agencies are more “efficient” is that such analyses are comparing institutions with distinctly different ends.

The inherent difficulty in comparing the “efficiency” of public and private providers of W&S services is that private providers have a simple primary function, while the functions of the state are much more complex. The primary goal of a private company is to make profit. Indeed, as law professor Joel Bakan (2004) observes, the sole responsibility of the officers of the corporation is to serve the interests of the shareholders, and most often the shareholders’ interest is to increase their share value. By contrast, when the government decides to provide a service, one of its primary goals is to secure political legitimacy.<sup>6</sup> As several histories of the public-private shifts in the W&S sector have demonstrated, in the 19<sup>th</sup> and 20<sup>th</sup> centuries state institutions assumed control over the W&S sector in order to maintain capital accumulation, assist in the reproduction of labor, and quell social unrest (Castro 2007: 759; UNDP 2006: 28-31).

<sup>6</sup>The subject of the “functions” of the state is an area of large academic debate. For a systematic treatment, see Clarke (1991).

The central assumption behind the privatization agenda, based upon neoclassical theory, is that the interests of the service provider (profit) are not only compatible with social objectives (universal access to clean water), but that institutions organized by the profit motive are more likely to achieve social objectives. As Marcus Taylor has observed:

The prescriptive core of neoclassical economic theory, which rationalizes neoliberal policy practice, is that sustained accumulation can be achieved through policies that actively impose the discipline of money and markets on both state and society. To impose this discipline is to enforce the limits of capitalist social forms upon social actors through the subordination of social relations to the logic of money and the rule of private property (cf. Clarke 1988). As long as social actors submit to the play of market forces mediated through monetary relations, the argument contends, the optimal conditions for accumulation will predominate to the benefit of the common good. (2004: 79)

According to the neoliberal view, state *abstention* from economic protection of citizens' economic and social welfare is conceived as the foundation of the good society. Unfettered market competition produces incentives for maximizing optimal resource use and individual responsibility, thereby making society better off in the long run in spite of harsh short-term effects on some people.

With the rise of the Washington Consensus in the wake of the 1980s' debt crisis, the state has increasingly come under attack for being necessarily wasteful, inefficient, and sub-optimal. The World Bank policy paper on water resources management argued, for example, that after decades of supporting the expansion of the public sector, it was time for a "new approach" because "[g]overnments have often misallocated and wasted water, as well as permitted damage to the environment, as a result of institutional weaknesses, market failures, distorted policies, and misguided investments" (1993: 9-10). The exact details on why this is said to be the case vary, but as Judith Rees (1998: 95) has summarized, the neoliberal position that the private sector is more "efficient" than the public sector rests on three inter-related arguments, which will be examined in greater detail further below: 1) the "absence of competition" argument: state organizations are insulated from the competitive incentives found within free labor, capital, or product markets; 2) the "overpoliticization" argument: state enterprises are exposed to short-term political interventions, struggles for political advantage, and the demands of special interest groups (such as trade unions) for privileges; 3) the "lack of accountability" argument: state firm managers can pursue their own utility rather than the public interest because the ultimate owners, the tax payers, have few effective mechanisms to signal their requirements or dissatisfactions with management.

By contrast, scholars and activists who oppose privatization tend to view the state as the guarantor of social citizenship rights. As noted by critical geographer José Esteban Castro, "the connection between access to water services and citizenship should be self-explanatory" (2004: 328), since the notion that water for human consumption is a universal right is found in many different cultures. The modern theory of social citizenship rights, as articulated by British sociologist, T. H. Marshall (1992), posits that public well-being in a democratic society depends on rights to economic security as well as political and social rights. In this view, the state has an important role to play in redistributing social wealth in order to achieve a degree of social equality. As neoliberal governments change the boundary of the state, water justice movement advocates contend that there is a similar transformation in the sphere of rights, as notions of "social citizenship" are giving way to a form of "lean citizenship," defined as the attempt to strip citizenship of any collective or social attributes in favor of a wholly privatized and marketized notion of rights. With privatization, the notion that all *citizens* should have access to a certain amount of water regardless

of their ability to pay is replaced by the concept that *consumers* should have access to water based upon their willingness to pay (Bakker 2001; Chng 2008).

Partisans of the water justice movement therefore evaluate providers on a different set of criteria, herein defined as “social efficiency.” As Louis Lefebver and Thomas Vietorisz argue, in contrast to the notion of “economic efficiency,” which focuses on narrow economic criteria in terms of input of capital and output in terms of household connections, “social efficiency” is judged by the impact that a given act, event, or institution has on public welfare more broadly. As they write,

[E]fficiency for its own sake cannot be a policy goal. Social concerns range over broad social and political-economic areas, some of which may conflict with each other. Policies and implementation must take this complexity into account.... There is a need for other, different criteria for efficient policy formulation and implementation, criteria that are suitable for the pursuit of diverse goals, such as equity, stabilization, and social and environmental sustainability. (2007: 139-140)

If the goal of a public water provider is to secure political legitimacy by enhancing well-being (such as public health and equal access to the service), it is relevant to assess its performance based upon the number and quality of jobs created, coverage rates, the quality and affordability of services offered to citizens, and whether or not the enterprise is taking care not to overexploit and pollute water resources.

A caveat is in order. As noted above, to observe that the state is motivated by different ends from the private sector is not to suggest that the “public interest” and the “state interest” can be thought of as synonymous. Indeed, within capitalist societies, the state plays the role of the “collective capitalist,” which intervenes in civil society to ensure the conditions necessary for capitalist reproduction. In many post-colonial settings, however, the state has a very weak capacity for regulation and law enforcement. As José Esteban Castro puts it, “civil society is often a euphemism for a small elite that enjoys full access to the status of citizenship while the bulk of society cannot afford to participate meaningfully in the social and political life owing to protracted conditions of social inequality, poverty, and vulnerability” (2007: 762). We will return to these issues further below in the discussion of accountability.

The following section assesses the neoliberal arguments that the public sector is inherently “inefficient” along the three axes identified above—problems related to lack of competition, over-politicization, and accountability—elucidating the contrast with alternative notions based on social criteria promoted by the water justice movement.

### 3. The Effects of Competition and the Profit-Motive

The first argument is based on the claim that private producers are more “efficient” than public producers because the profit-motive drives private managers to cut costs, raise labor productivity, and maximize profits. According to the neoliberal view, in the absence of competitive pressures of the market, public sector utilities have charged less than the costs of production for water, which is seen as neither economically efficient nor equitable, especially as services tend to privilege relatively affluent populations, with poor areas underserved and in some cases not served at all (Guasch and Spiller 1999; World Bank 2004). It is assumed that private companies who sell a product will out-perform public providers because they are driven by competitive pressures of the market. Neoliberal water policy therefore suggests three ways to introduce competitive dynamics in the sector: creating new pricing mechanisms, bringing in equity financing, and introducing private sector participation.

### 3.1. Pricing Water: Marginal Cost versus Increasing Block Tariff

According to the neoliberal perspective, water should be treated as an “economic good” and priced accordingly. Proponents of the water-as-economic-good approach argue that people often treat water as if it were worthless, and that if consumers are not paying for it, they will waste it. The value of water must therefore be made evident through pricing mechanisms. According to this approach, the “true value” of water is best achieved where the market model of development is used; prices become the mechanism which sends appropriate signals to everyone about decision making on allocation, distribution, and consumption. Or, as the *Economist* magazine recently put it, “Clean water is a right, but it must also have a price” (2006). It is hoped that introducing user-pay principles will both encourage conservation and increase distributional equity by generating the financing needed to expand formal water networks.

Since public water utilities have historically charged less than the costs of production, introducing full cost recovery principles invariably entails raising water tariffs, particularly those paid by the poor.<sup>7</sup> The recommendation to raise water tariffs is justified with reference to the fact that those who rely on the “informal” water sector often pay much higher prices per liter of water than those who rely on the formal water system. As political ecologist Karen Bakker argues, the high prices paid by the poor “are interpreted as evidence of their ‘ability’ (or sometimes, and more dangerously, their ‘willingness’) to pay for water services, at rates high enough to ensure cost recovery, and even profitability of water supply systems” (2003: 336). She cites a publication of the Department for International Development (UK) that states:

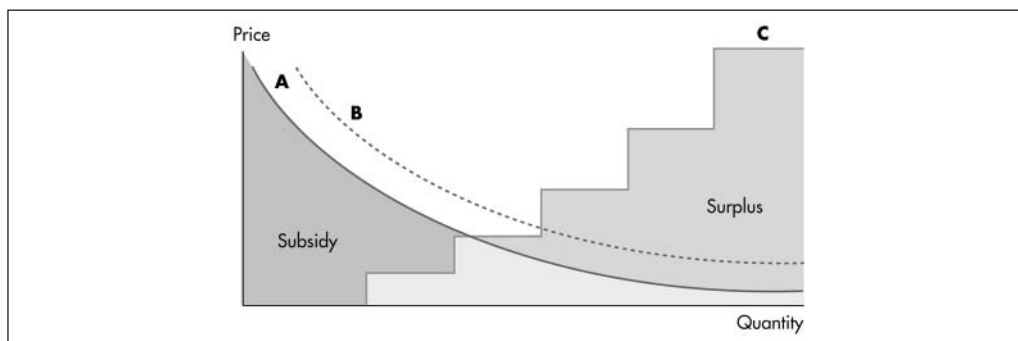
People in poorer areas where piped supplies are not available usually have to buy their water from vendors. Experience around the world shows that the cost of buying water in this way is far higher, from a low of 4 times up to 100 times more than from public utilities.

This mostly affects the poorer members of society who are least able to afford to pay—but they must, in order to survive. (cited by Bakker 2003: 336)

The underlying supposition is that full cost recovery pricing is both possible and desirable. As Isabelle Fauconnier (1999: 48) has observed, however, taking the willingness to pay argument to its logical extreme, it could be interpreted that the fact that a poor household that pays up to 25 percent of its income to obtain potable water from private vendors is willing and able to pay that amount, since it actually pays it in practice. By extension, such reasoning would result in unfair pricing decisions. The willingness-to-pay argument ignores the problem of the non-substitutability of water: if the household had cheaper options, such as less expensive municipally supplied water in its neighborhood, it probably would be willing to pay less in order to purchase other basic goods. By pushing the willingness to pay reasoning too far, policy makers may find it acceptable to set municipal water prices at levels corresponding to 25 percent of a poor household’s income.

The prospect that the unconnected poor should be expected to pay the full costs for services also raises the problem of inter-generational equity, which is of particular concern in the context of white settler states characterized by a history of “service apartheid” (Bond 2002b; Crespo Flores 2004; McDonald 2008). In the context of racially-divided states such as South Africa, in which white and black populations had different levels of services, the shift towards full cost

<sup>7</sup>One study suggests that during the 1990s, the predominantly public W&S utilities in Africa, Latin America, and the Caribbean covered only 30 percent of their production costs through user fees, on average; in Asia, this figure was only about 20 percent (World Health Organization 2000).



**Graph I.**

Source: Bond (n.d.: 3)

recovery policies demonstrates what Martha McClusky (2003: 785-6) labels neoliberalism's "racialized, genderized, and class-based vision of social equity and community solidarity that favors the interests of the most privileged members of society."<sup>8</sup> The historical co-existence of formal water systems supported by the state and informal water systems represents a net transfer of resources from the poor to the rich: the unconnected poor, black, or indigenous population has subsidized the public system by paying taxes or purchasing water in tankers at much higher prices, while the main beneficiaries have been the more affluent, white population who are connected to the public system (Bakker 2003; Swyngedouw 2004). While disguised as a policy that promotes "efficiency," the net effect of the policy of full cost recovery is to entrench racial, gendered, and class inequality by reinforcing the status quo and ignoring this historical debt.

According to the neoliberal view, "getting the prices right" by introducing market logic in the water sector also involves marginal cost pricing. The World Bank recommends marginal cost pricing on the grounds that it sends the most "efficient" pricing signals to consumers. Under this method, higher volume users—who tend to be wealthier—should be charged less per volume of water, and lower volume users—typically the poor—should be charged more. As political economist Patrick Bond (2004: 3) has argued, given the possibilities of economies of scale in water service delivery, the higher the consumption, the less it costs to supply each additional unit. As Graph 1 indicates, the marginal cost supply curve for water services therefore slopes downward (Line A). To ensure proper functioning of the market and to create profit, there must also be a mark-up across the board (Line B).

By contrast, the alternative pricing mechanism put forward by the water justice movement, the increasing block tariff (IBT), is based upon a sliding scale. The IBT is "socially efficient" since it is based upon users' ability to pay: those with a greater ability to pay should be charged more per liter of water than those with a lesser ability to pay (Line C). By imposing a block tariff that rises for larger-volume consumers, the state consciously distorts the relationship of cost to price. In South Africa, however, the way that the increasing block tariff structure has been administered has penalized the poorest households (Bond 2002a). The poorest households, which may have up to 20 family members living under the same roof connected to one meter, tend to consume higher volumes of water. In order to rectify this problem, social movements in

<sup>8</sup>Across the globe, income inequality rose between 1960 and 1990, and absolute poverty (people living on less than one dollar a day) increased significantly in the last decade in Latin America and the Caribbean, Europe and Central Asia, and sub-Saharan Africa (ILO 2004: 40-49).



South Africa are now demanding that the government raise the allotted minimum consumption and slope cost curve more gradually (Loftus 2006: 1038).

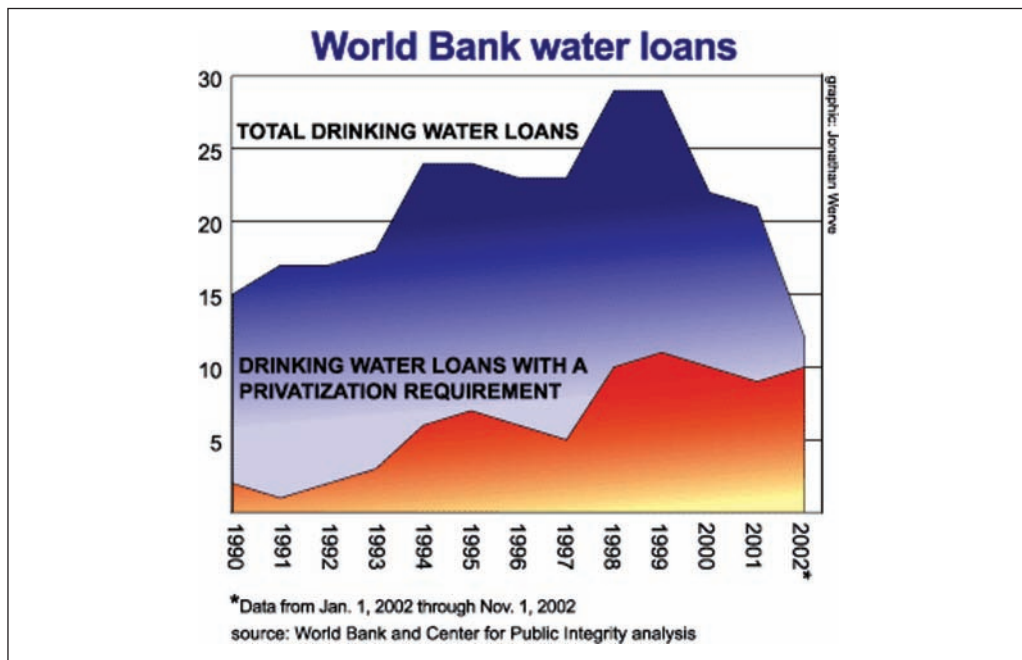
### 3.2. *Alternative Sources of Financing: Equity versus Debt Financing*

The enduring problem facing both public and private providers is that water projects, particularly new ones, require enormous upfront sunk cost investments. Due to the high capital intensity needed for urban water services infrastructure (e.g. treatment plants, dams, reservoirs, excavation, installation and maintenance of pipes), it is difficult to recover costs in the short run through water tariffs, whether through marginal cost pricing or increasing block tariffs.

While water has been touted as the next “blue gold,” the growing number of failed experiments with water privatization suggests that trying to sell water for a profit to poor people in the global South is much more difficult than originally thought. Investments in W&S infrastructure are “lumpy,” or large relative to the size of the market. W&S assets also have a useful life that is several decades or longer and are often installed well in advance of demand. Taken together, these features imply a sector with substantial revenue risk to service providers, and much more so than other infrastructural sectors such as telephone or electricity (Davis 2005: 151). Investments in the water sector are considered “lumpier” than in other infrastructure sectors that also have a tendency towards natural monopoly, meaning that it often takes a long time to turn a profit if profit is ever made. Under these conditions, setting tariffs to balance the needs of the private sector for return on investment with social needs for affordable water has proven to be extremely difficult to accomplish in practice, especially in unstable economies prone to currency devaluations. A World Bank database on infrastructure revealed that, by 2002, 75 percent of contracts for water privatization in Latin America and the Caribbean had experienced either renegotiation or cancellation, largely due to disagreements over tariffs and investments (Gómez-Ibáñez, Lorrain, and Osius 2004).

Given the need of large amounts of capital to fund the expansion of W&S networks, one of the main arguments supporting privatization was that it would introduce new sources of finance. Multinational corporations were also thought to bring particular efficiencies to the sector because they can create economies of scope and scale, which would further bring down the costs of investment finance. Theoretically, a firm that is producing water in hundreds of cities will perform better than a firm in one city because of the higher yields the group can attain (Lobina and Hall 2003; Robbins 2003). Furthermore, only multinational corporations had access to equity financing. Although the risks involved with equity investment make it much more expensive, at the height of the privatization debate in the 1990s it was viewed as desirable because shareholders would put pressure on managers to make efficiency gains, which was supposed to offset the increased cost of capital.

In practice, however, governments and multilateral lenders have in many cases provided special incentives and heavy subsidies to risk-averse multinational corporations in order to attract investors to the sector. In Conakry, Guinea, for example, more than 80 percent of the US\$175 million (in 1996 dollars) invested in the city’s W&S infrastructure during the first eight years of its private-sector lease agreement was financed by the World Bank and bilateral aid agencies (Clarke, Menard, and Zuluaga 2002). Similarly, in La Paz-El Alto, Bolivia, an independent auditor found that out of the \$120 million invested over the life of the contract, only \$11.3 million came from the private company (Crespo Flores 2006). In other cases, governments have committed in advance to guarantee a risk adjusted rate of return on a private company’s investment, which has allowed “price gouging” (e.g. when the charge price is much greater than the “marginal cost”). In the concession contract in Cochabamba, Bolivia, for example, the firm was guaranteed a return on its investments of 13 percent, which helped to justify the tariff increases that set off the famous “Water War” of 2000 (Nickson and Vargas 2002: 111).



**Graph 2.**

A recent report authored by researchers with the Public Services International Research Unit suggests that the net effect of the privatization agenda of the 1990s on investment has been negative (Hall and Lobina 2006). At present, there is a huge gap between the amount of financing required to meet the Millennium Development Goals and what the private sector has been willing to invest thus far. In order to meet the Millennium Development Goals of halving the amount of people without clean water supply between 2006 and 2015, it has been estimated that 270,000 people per day would need to be connected. As David Hall and Emmanuel Lobina suggest, over the last nine years, the private sector has connected 900 people a day. International donors, who expected the private sector to pick up the slack, substantially cut their own investment in the W&S sector (see Graph 2). The authors conclude that “the net contribution of 15 years of privatization has been to significantly reduce the funds available to poor countries for investment in water, by billions of dollars” (2006: 6).

Alternative financing mechanisms are therefore needed for the W&S sector. The most cost-effective form of financing has traditionally been debt financing, either from international financial institutions or in the form of government bonds. However, as David Hall (2004) argues, in some cases it may be possible to mobilize the necessary resources within local communities to construct domestic extensions, even if the government, municipal, and water authorities are failing to function. Local solutions require attention to low-cost suitable technologies. In reality, given the high level of need for finance for basic W&S infrastructure, public water services can only be made affordable through a combination of financing mechanisms: taxation, tariffs charged to users, efficient methods of billing, and most importantly, cross-subsidization. If capital markets exist, it is preferable to raise investment finance through nationally-issued loans or bonds to avoid the problem of currency risk. Development banks also have a role to play, although in the past the effects of policy conditionality have eroded the sphere of democratic decision making. In South America, the newly-established Bank of the

South also provides a potential source of development finance that may provide a model for regional development banks elsewhere.

### 3.3. Regulation and Competition: Public versus Private Monopolies

Despite the emphasis in the neoliberal privatization agenda on competition as a means by which to improve performance of water agencies, the scope for competition within the W&S sector is extremely limited. With the exception of small-scale independent providers, W&S service providers typically operate as local monopolies. The concession model of privatization, which was the most popular form of private sector participation in the W&S sector in the 1990s, aimed to overcome this barrier by introducing competition *for* the market since competition *within* the market is impossible. The hope was that by granting a concession in a competitive environment, prospective service providers would outbid each other. This was projected to result in “pro poor” contracts that guaranteed optimal conditions for users: reduced tariffs, more connections, and improved water quality and quantity (World Bank 1994; World Bank 2004).

Kate Bayliss (2001) points out the logical fallacy of the privatization argument, which has made negotiating “pro poor” contracts in the W&S sector of poor countries a very difficult task: those public utilities that are in greatest need of reform are the least like to be privatized. Private companies are simply not interested in investing in poorly-functioning public utilities with dilapidated infrastructure. Indeed, over the past 15 years, multinational water companies have invested in regions and areas of cities in which profits could be made, leaving the rest to be served by the public sector or the informal private sector. This tendency to “cherry pick” contracts is evident in the strong regional and national concentrations of private sector participation in the water and sewerage sector, with the largest number of projects and proportion of investments concentrated in relatively more affluent regions of the world: Latin America and East Asia, and not, for example, sub-Saharan Africa (see Table 1). Moreover, in cases such as the concession contracts in La Paz-El Alto, Bolivia and Buenos Aires, Argentina, concession contracts were designed to exclude the least profitable customers—those most in need of services—by drawing geographical boundaries around the “service area” (Budds and McGranahan 2003; Laurie and Crespo 2007; Loftus and McDonald 2001).

Privatization has also put pressure on states to “unbundle” services, which creates externalities, particularly for the environment. The dirty secret of the W&S sector is that water is the only profitable aspect of the service. Unlike sanitary sewerage, water that is delivered to the home is regulated by a valve that can be shut off in the case of non-payment. On the other hand, once installed, sanitary sewerage systems cannot be shut off. For this reason, fees for the collection and treatment of waste water are frequently folded into water tariffs and W&S services are provided by the same company. One of the strategies used by governments wanting to make the contract more attractive to private bidders, however, is to separate W&S services. In the case of the La Paz-El Alto contract, for example, the private operator managed to externalize the costs of the city’s rain drainage system thus making it look “more efficient” than the former public utility but causing great damage to the environment.

Once the contract is signed, the discipline of competition erodes as each household becomes the customer of a local monopoly service provider. The performance of the company is therefore thought to depend on strong state regulation (World Bank 2004). Contrary to the World Bank’s claim that government regulation of private providers is preferable to direct provision of services, however, private contracts present their own difficulties. Driven by the profit motive, private firms have a vested interest in opposing increased competition and strong regulation. Indeed, as Judith Rees observes, “most regulation only works effectively with the consent of the regulated, being based on an acceptance that the ‘commands’ are reasonable” (1998: 103). She further notes

**Table 1.** Private water and sewerage projects in low- and middle-income regions, 1990–2007\*

Region	Number of projects	Investment (millions of US\$)
East Asia and Pacific	282	27,225
Europe and Central Asia	82	5,312
Latin America & Caribbean	196	23,018
Middle East & North Africa	15	1,082
South Asia	9	255
Sub-Saharan Africa	24	266
Total	608	57,159

\*These figures come from the World Bank Private Participation in Infrastructure (PPI) database. Investment refers to total investment, not private investment alone. Also, many small projects are omitted.

Source: [http://ppi.worldbank.org/explore/ppi\\_exploreSector.aspx?sectorID=4](http://ppi.worldbank.org/explore/ppi_exploreSector.aspx?sectorID=4) [accessed April 29, 2008]

that “regulation is often demanded by private firms to increase their market, curb risks or reduce competition by creating barriers to entry for new firms or substitute products,” not to make them better and more equitable service providers (1998: 103).

The regulatory challenges have only increased with the addition of a powerful interest group in the regulatory process: the multinational corporation. The world water market is dominated by three large companies: Ondeo (French, formally Suez-Lyonnaise des Eaux), Vivendi Environment (French), and Thames Water (owned by German RWE). Each of the three leading companies has enormous financial resources, and is among the top 100 corporations in the world. Together they earned US \$156.7 billion in 2001, and they continue to grow at about 10 percent a year. Ondeo and Vivendi split over 70 percent of the private water market (Finger and Allouche 2002). Recent investigations have found that these “water barons” are engaged in uncompetitive practices in order to restrict entry of new companies by establishing joint ventures, even with their nearest competitors, in order to corner new markets (Lobina and Hall 2003: 6). Due to restricted entry, only a handful of multinational corporations are capable of operating on the global scale, which has significantly reduced the sector’s *de facto* competition.

#### 4. Public Water Utilities are “Over-politicized”

Improving efficiency also means cutting costs, which leads to the second main argument about the “over-politicization” of the public sector. Neoliberals argue that public sector utilities are “inefficient” because they are easily co-opted by “special interest groups,” particularly organized labor. This sensitive political issue has not received as much attention as it deserves either from critical scholars or activists within the water justice movement.

Labor unions are almost nearly universally depicted as “special interest groups” in literature on the water sector. In the recent World Development Report on how to improve public service delivery to the poor, labor unions are identified as potential “stakeholders” but also barriers to reform, particularly in the education sector (World Bank 2004: 8, 61, 101, 148, 169, 190, and ch. 7). Privatization scholars Andrew Nickson and Richard Franceys summarize much contemporary thinking in the following statement: “however strong is the trade union resistance to change, formal sector workers employed in water utilities remain the ‘privileged few,’ in comparison to the poor consumers who stand to benefit most from the merit-good nature of water” (2003: 158).

Public sector unions have been a favorite target of attack in neoliberal reform. Indeed, one of the universal features of neoliberalism as a political project has been an emphasis on “maintaining downward pressure on wages to combat inflation and thereby achieve price stability,” which is seen as “a crucial determinant in the global political economy ... [since a] lack of

‘competitiveness’ translates directly into a loss of jobs and profits” (Burnham 1999: 46). Governments facing fiscal pressures often seek to weaken or destroy the bargaining power of unions in order to claw back workers’ wages and benefits by using arguments that these “privileged workers” are overpaid relative to the rest of the population (Hall 2005). Unions that represent workers in water utilities have been no exception to the rule.

Public sector unions find themselves in a difficult political situation in highly segmented labor markets in which the majority of the working population is engaged in “informal” types of work. In such a context, public service workers tend to be viewed by other members of the public—even their anti-privatization allies—as a privileged “labor aristocracy” (Spronk 2007b). Under such conditions, meeting citizens’ right to an affordable water supply and workers’ rights to decent wages, benefits, and working conditions becomes a challenging political balancing act. In the neoliberal era, the emphasis of most commentators—and even some social movements fighting against water privatization—has been to defend “consumer” rights against “workers’ rights,” as if these two issues were mutually exclusive (see, for example, Oxhorn 1998). Representing workers’ and consumers’ rights as if they are in conflict, however, only perpetuates the idea that other workers should lower their living standards in order to cheapen wage goods.

In a recent report, World Bank economists find that improvements to efficiency associated with privatization were mostly driven by a reduction in staff numbers. The report, which is based upon a survey of over 1,200 utilities in 71 developing and transition countries, finds that privatized water companies have lower staff levels of about 16 percent (Gassner, Popov, and Pushak 2007: 13). In Buenos Aires, for example, the number of staff was nearly halved when a private concessionaire took over the city’s W&S networks (Loftus and McDonald 2001). The ratio of staff to 1,000 connections was cut from 8.5 to approximately 4 in the dual concession contracts signed in Manila, Philippines (Wu and Malaluan 2008). In Conakry, Guinea, a 30 percent reduction in staff occurred immediately following the signing of a lease agreement for the operation of the city’s water and sewer network by a private firm (Clarke, Menard, and Zuluaga 2002).

From the perspective of “social efficiency,” then, the privatization of public water utilities has an overall negative impact on social welfare due to its impact on unemployment. If, as the World Bank claims, the objective of “development” is to reduce poverty and poverty is related to unemployment, then privatization conflicts with that goal. As Kate Bayliss (2001: 15) writes:

Privatisation is widely associated with labour layoffs and retrenchments .... If privatisation is not going to increase poverty it must be assumed that either a) there is a labour market capable of absorbing laid off workers and/or b) that such losses are short term and subsequent expansion under private ownership will compensate for initial job losses. Sadly, neither of these seems to apply.

Indeed, no analyses to date have examined the ease with which laid off utility staff are able to find new jobs.

Despite the negative views about public sector trade unions as a “privileged” class of workers, in several cases trade unions have played a crucial role in restructuring public utilities into effective organizations. As Judith Tandler has observed, despite the vast literature in industrial performance and workplace transformation that demonstrates how high worker morale is related to increases in productivity, the development community “pays little attention to worker commitment, except to argue that workers are doomed by their self-interest to be uncommitted” (1997: 136). Based upon a comparative study of four public service programs in northeastern Brazil, Tandler concludes that the re-organization of tasks to provide more worker autonomy and increase job satisfaction and worker commitment was one of the key factors that explained why reforms were successful. As David Hall, a researcher with the Public Services International Research Unit

argues, “[l]ower staffing levels do not automatically imply greater efficiency, they may simply reflect inadequate resources” (2001: 19). In Central America, for example, Hall finds that higher production of water per staff person is related to higher levels of unaccounted for water and lower levels of service quality. To the contrary, in Dhaka, Bangladesh, doubling workers’ salaries led to an improvement in the finances of the utility, because workers could “afford to be honest.” Collection rates increased dramatically (Hall 2004: 4).

## 5. The “Short Route” versus the “Long Route” of Accountability

The third argument about the supposed inefficiency of the public sector is that managers—particularly in corrupt Southern countries—are unaccountable because they pursue their own goals instead of the public interest. Too often, public water utilities have been used as what Latin Americans call “*botín político*” (political booty), which is precisely why there is a need for public sector reform. Unless they are subject to certain constraints, politicians can abuse their power by appointing managers and personnel as a means to strengthen their clientelist ties, handing out jobs to their allies based upon their political orientation rather than their competence. This practice may distribute resources to political elites but represents a significant drain on public finances because it leads to over-staffing with redundant and unqualified personnel. In his study of the public water utility in Guayaquil, Ecuador (before its privatization in 2000), Erik Swyngedouw (2004: 158) found that at one point in the early 1990s there were 1,500 people registered on the payroll, many of whom received pay checks but never showed up for work.

The problem of accountability is a fundamental problem upon which free market ideologues and water justice movement activists can agree, but they have divergent views about how to fix it. The question is *what kinds of constraints* are needed to remedy the situation. Both sides agree that improving the accountability of institutions to encourage rule-bound behavior will likely enhance performance and raise the quality of public services, but they fundamentally disagree on who should set these rules and what these rules should look like.

Free market ideologues argue that the profit-motive acts as the most effective constraint on individual behavior and therefore privatization represents the “short route” to utility reform (World Bank 2004). As captured by the following quote, a senior staff person at the World Bank, Menahem Libhaber, argues that the private sector demands more efficient and professional management than the public sector (e.g. they are not “replaced every three years”) because the private sector must respond to “economic” or market imperatives instead of “political” ones.

Democracy is [a] good thing—but elections every two to three years, a new mayor comes in, he replaces the entire utility management because that is [in] his power, he must reward his friends, and the new management does not have a clue what is going on. And that is the reason [that] at a certain point the only way to do it is [to bring in] the private sector because the private sector is not replaced every three years. (cited by Carty 2002)

The division between the “economic” and “political” implicit in Libhaber’s statement is based upon the neoliberal view that money and the market are the efficient means of the regulation of capitalist reproduction (Clarke 1987; Taylor 2004). Despite the claims that “democracy” and the “free market” are synonymous, neoliberal economic theory therefore rests on a cynical view of democratic politics, regarding any political determination of economic outcome as essentially leading either to social waste or to the dominance of minority interest over the majority interest. The underlying assumption is that any pursuit of self-interest that is not disciplined by market forces (politics being the most dominant form of such pursuit) will lead to socially harmful

results, making it necessary to depoliticize economic decision making (Bourdieu 2002; Burnham 1999; Fine 1999).

The alternative approach, promoted by the water justice movement, proposes that improving the accountability of service providers requires the *deepening of democracy* in order to force policymakers to be more responsive to citizen's needs. According to this critical view, privatizing public utilities does not increase "accountability," but to the contrary, pushes decision making even further from the reach of citizens, placing it into the hands of a select group of shareholders, owners, and their managers (Chng 2008; Olivera and Lewis 2004; Sjölander Holland 2005). Moreover, multinational corporation involvement has been characterized by a lack of transparency, secrecy, and cases of corruption (Hall 1999). Public forms of provision may not be perfect, but at least they create more room for democratic process than private forms of delivery.

The most radical elements of the contemporary water justice movement have articulated an anti-statist critique born from the perception that the forms of development pursued by the state in the previous development era were exclusionary and marred by the classist politics of clientelism. According to this movement, a radical project of social transformation requires a "different kind of state" based upon the principles of collective ownership and popular democracy. The goal, then, is to democratize public forms of water delivery, or better yet, replace contemporary statist forms of management with decentralized and participatory institutions in which citizens can vote for their preferences directly.

Contemporary water justice activists therefore stress the importance of collective ownership and popular democracy as the means by which to improve public utilities. As stated by Bolivia's Coordinadora de Defensa del Agua y de la Vida (Coordinator for the Defence of Water and Life—the Coordinadora), the organization that emerged to coordinate the protests during the Cochabamba Water War of 2000, "the fundamental problem is who decides about the present and future of the population, natural resources, work and living conditions. In relation to water, we want to decide for ourselves: this is what we call Democracy" (cited in Crespo Flores 2006: 4). One of the models from which the water justice movement draws its inspiration is the successful effort to introduce public participation in deciding public spending priorities in the urban areas of Brazil, most notably Porto Alegre, Brazil. DMAE, Porto Alegre's publicly owned and operated water and sanitation utility, has not used the profit motive to reform management practices, but it instead has used public participation to make policymakers accountable to citizens. As discussed by Hélio Maltz (2005), a certain amount of the public budget is decided upon through a yearly democratic process in which delegates who represent different territories of the city vote on public investment priorities. As a result, in 2004 Porto Alegre was considered the Brazilian state capital with the highest quality of life and the highest human development index. Around 99.5 percent of the city is supplied with good quality water and 84 percent of the city receives sewerage treatment (Mehta and Miroso Canel 2004: 25).

## 6. Conclusion

As this paper has attempted to show, the ideological claims upon which the case for privatization rests are both empirically and theoretically flawed. Despite the claim that introducing private sector participation in the W&S sector is the "short route" to reform, the scope for competition in the sector is highly limited. Proposals to reform pricing mechanisms according to the "logic of the market" are not "socially efficient" because they redistribute wealth from the poor to the rich. Arguments that suggest the private sector is more "efficient" fail to consider the impact of privatization on society as a whole. The drive to re-organize service delivery to make it profitable has also had deleterious effects: poor customers—those most in need of services—have tended to be

excluded from concession contracts; non-profitable aspects of W&S services, such as sanitary sewerage and rain drainage, have often been left to the public sector. Nor have the promised sources of finance materialized. In short, rather than introducing competition, privatization involving large multinational firms has simply replaced public monopolies with private, profit-seeking monopolies.

In sum, there is thus a compelling case to be made that existing public infrastructure should not be transferred to the private sector. But, as Lyla Mehta and Oriol Miroso Canel argue, it would be equally amiss “to call for a simplistic return to public systems as we knew them.... What is urgently required is a revitalized and invigorated commitment to re-enhance financing and reform public systems which do not emphasize profits and can instead focus on enhancing poor people’s entitlements to water” (2004: 28). It is undeniable that reform of the local state and public utilities are required in order to extend universal services in many states of the South. More research is needed, however, to help specify the conditions under which public utilities function well (Spronk 2007a). Since most progressive research efforts up to this date have focused on the problems with privatization, the factors that determine quality *public* management are poorly understood.<sup>9</sup> Now that the multinationals are in retreat, however, there is more political space to discuss real alternatives.

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<sup>9</sup>For an important collaborative initiative that highlights several cases of well-functioning public water utilities throughout the world, see Balanyá, Brennan, Hoedeman, et al. (2005). and the Municipal Services Project at <http://www.municipalservicesproject.org/>



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