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“Social policies and private sector participation in water supply – the case of Brazil”

André Rossi de Oliveira
University of Brasília, Brazil

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UNRISD, Palais des Nations
1211 Geneva 10, Switzerland

Tel: (41 22) 9173020
Fax: (41 22) 9170650
E-mail: info@unrisd.org
Web: <http://www.unrisd.org>

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1. Introduction

Up until the 1960's, the provision of water and sanitation services in Brazil was very deficient, lack of appropriate water and sewage treatment, inefficient operation and faulty regulation being the norm. Moreover, there were different management models in place. Some municipalities provided water and sanitation services independently, while others formed consortia with neighboring municipalities. The most successful model was apparently one where state departments were in charge of the entire production process, including planning, construction and operation (Turolla 2002).

Recognizing the close connection between economic and social development and access to basic public utility services, the military government instated in 1964 elected as one of its priorities the promotion of universal water and sanitation services. One of the actions taken by the government in that direction was the creation of the National Housing Bank (BNH) in 1964. Its initial mission was to implement an urban development policy, but it was later expanded to include assessing the situation of the water and sanitation sector in Brazil and financing of its expansion.

In order to have access to the financial resources made available by BNH through the Sanitation Financial System (SFS), municipalities were required to organize service provision in the form of autonomous departments or mixed ownership companies (Turolla 2002). This model resulted in a water and sanitation sector where supply of water and sewage services by municipalities was predominant, with only a few municipalities relinquishing operation of those services to the state.

The establishment of the National Sanitation Plan (Planasa) in 1971, however, changed the picture. The plan laid out investment schedules for the sector, as well as tariff, credit and other sector policies. It also promoted the creation of state water and sanitation companies (CESBs), encouraging municipalities to grant long term concessions to those companies in exchange for financial resources coming mostly from BNH. This centralization was defended at the time based on two arguments. The first one was that there existed economies of scale in large metropolitan areas to be captured and a need to reduce planning costs. The second was the alleged need to introduce cross subsidies, whereby more profitable regions would finance less profitable ones.

The incentives faced by the CESBs under Planasa were such that construction and expansion plans were privileged, with a detrimental effect on operations (Rezende 1996). Loans from BNH, for instance, were not available for activities pertaining to companies' operations, a consequence of the government's directive to finance the expansion of infrastructure. This eventually resulted in the deterioration of water and sewage systems, leading to high system losses. At any rate, coverage of water provision in urban areas in Brazil augmented from 60% in 1970 to 86% in 1990 under Planasa, while coverage of sewage collection increased from 22% to 48% in the same period of time (Seroa da Motta 2004).

By the end of the 1980's, though, the performance of the highly centralized Planasa system had deteriorated significantly. The Brazilian economy was facing a hyperinflationary process which led the government to keep companies' tariffs under tight control in order not to fuel inflation. Dwindling investments due to lack of appropriate financing (BNH ceased to exist in 1996 and there was a sharp decrease in foreign capital inflow), political meddling and mounting debt service from previous loans anticipated a gloomy future for the water and sanitation sector.

Brazil has been experimenting with the PSP through various forms such as concession contracts. In the urban areas, it is estimated that there are some 1,350 water and sewerage entities, of which 32 have been privatized (Owen 2006). Currently, 25% of the population is served by the private sector and this figure could grow to 36% within 10 years.

The main objective in this chapter is to study past and ongoing experiences with private provision of water services in Brazil and to assess the impact on access and affordability indicators. We will also try to analyze the social policies in place to help the poor. The chapter is divided in seven sections, including this Introduction. In the second section we provide, as background, an account of the recent evolution of the sanitation sector in Brazil, with particular interest in the participation of private capital. We also present a literature review on private provision of water services in Brazil. The following Section looks at social policies and regulation and describes in detail the specific programs implemented in the country. Next Section discusses some indicators of access to and affordability of water supply in Brazil that bear out the main problems in the sector. In the subsequent Sections we bring the results from a plethora of estimations of different econometric models that try to measure the effects of private provision on access and affordability. The last section concludes.

2. Private provision of water services in Brazil

2.1. Current developments in water sector

As discussed above, the Planasa system was dismantled by the Brazilian Constitution of 1988, conspicuously pro-decentralization, and was subsequently abandoned. After its collapse, no consistent set of policies for the water and sanitation sector was put in place to fill the void, a situation that has persisted until now. A law regulating the management of water resources in Brazil was passed by Congress (Law 9.433, January 8, 1997), but it was difficult to pass legislation specific to the water and sanitation sector, mainly because of disputes between municipalities and states over the right to grant concessions.

The Constitution established that public services such as water and sanitation should be provided by the State either directly or through concessions, and also authorized municipalities to grant concessions. The Constitution and the “Concessions Law” of 1995 (Law 8.987), however, are ambiguous when it comes to establishing which level of government is responsible for the provision of water and sanitation services and who has the power to grant concessions. The Constitution gave the municipalities the right to grant concessions of public services of local interest, but recognized that the federal and state governments should guarantee efficient and adequate regulation of water and sanitation services. These two provisions caused confusion as to how water and sanitation services in municipal and metropolitan areas, in most cases part of the concession areas of regional companies, should be regulated.

The “Concessions Law” also determined that the municipalities should have the power to grant concessions or provide the services themselves. However, it kept the door open for the regional companies (CESB’s) to play a role by specifying that the municipalities could only renew concession contracts through public tenders, in which the regional companies could participate.

With the monetary stabilization achieved by the Brazilian economy through the “Real Plan” (Real is the name of the currency introduced in 1994), the water and sanitation companies tried to recuperate their investing capacity and align revenues and costs, to no avail. Inappropriate management practices and lack of incentives for efficiency played a significant role in that

failure. It should be noted that after investments reached their lowest value in the biennium of 1993-1994, they recovered in 1998, but then immediately experienced another reduction. The improvement in the period 1994/1998 can be attributed to weak fiscal controls that led to a significant reduction in the primary fiscal surplus in those years. When those controls were tightened up again and a sound primary surplus received high priority, investments in the sector suffered a deep reduction. The renewed effort to balance the budget led to the approval of the “Law of Fiscal Responsibility” in 2000. The law established limits on public indebtedness, both on the direct administration and on companies where the government was the majority shareholder. Moreover, credit ceilings to public sector borrowing prevented the financial system from lending to public companies. Therefore, even when financial resources were available, service providers could not tap into them due to their public status.

In an attempt to restructure the sector, in 2001 the government submitted a project of law to Congress, known as PL 4.147, which gave sanitation companies administrative and financial autonomy, established pricing principles and concession criteria. Moreover, it established the state as the authority with the power to grant concessions in metropolitan areas, instead of the municipalities. The idea was to assure the financial viability of the state sanitation companies by allowing them to keep, at least in part, their ability to reap scale economies. These gains should be available to finance cross subsidies to poor municipalities within the area covered by the firm.

The pricing principles introduced by the bill were based on incentive regulation, more specifically on price cap and yardstick competition methods. The main objective was to promote efficiency and participation of private capital. The weak flank of the bill was its inability to set a governance structure for the sanitation sector, shying away from a proposal to create a regulatory agency.

The bill ran into the opposition of many stakeholders. The municipalities were against it mainly due to its provision that states were to have the power to grant concessions in metropolitan areas. There was also resistance to the project coming from segments reluctant to accept its directives regarding privatization, universal service and other issues. In particular, some questioned the participation of the private sector in sanitation, arguing that its profit-seeking motive was inconsistent with the provision of such essential services like water and sewage.

One of the major concerns of the government of President Lula da Silva, which came to power in January of 2003, was to restructure and restore investments in the sanitation sector. The federal administration set up a task force within the Ministry of Cities to elaborate a draft bill to be submitted to Congress with the new regulatory framework for the sector. In a nutshell, the proposal suggests that the concession power should be assigned to municipalities when the service is of local interest and that pricing as well as concession procedures should be regulated by autonomous authorities. It should come as no surprise that this proposal has run into the same kind of difficulties as the one submitted by the previous administration, opposing those who support municipalities’ powers against those who want to preserve the cross subsidy system operated by state sanitation companies (Seroa da Motta and Moreira 2004).

After a long period of discussions and some modifications, the bill was approved by Congress and sanctioned by the President in January 2007. It establishes criteria for municipalities and states to access federal financing and determines the constitution of councils with the participation of the civil society. These councils have leverage to influence municipalities’ decisions regarding tariff setting and termination of service due to lack of payment. The bill does not clearly define powers of concession, a matter that apparently will have to be decided by the country’s highest court. It does, however, establish that investments made by

concessionaires will have to be reimbursed in case their contracts are unilaterally terminated by the municipalities.

It stands to reason that the new bill will change the face of the Brazilian water and sanitation sector, which still reflects the guidelines set by Planasa in 1971. The sector is dominated by the regional companies, the CESBs, which still hold concessions from municipalities. Municipal provision of water and sanitation services is concentrated mainly in the states of São Paulo, Minas Gerais and Rio Grande do Sul, either through agencies under direct municipal control, autonomous agencies or municipal companies. There are a small number of cases corresponding to private companies currently holding partial or full municipal concessions.

2.2. Private sector participation in the water sector in Brazil

In the North region of Brazil, Manaus, the capital of the state of Amazonas, and Novo Progresso, in the state of Pará, are the only cities where water is supplied by private companies. In the Midwest, there are private enterprises in the states of Mato Grosso, Mato Grosso do Sul and Tocantins. The Southeast concentrates most of the private experiences, mainly in the states of São Paulo and Rio de Janeiro, but also in Espírito Santo and Minas Gerais. In the South, the states of Paraná and Santa Catarina have tried private provision of sanitation services.

There is considerable diversity in private enterprises undertaken so far in terms of financing and tariff structures. In some cases, companies subscribed the totality of their initial capital, while in others relatively sophisticated financing schemes including equity and debt were set up. However, many loans pledged to the new concessionaires by private and public institutions did not materialize (Parlatore 2000). Tariff structures are in line with those adopted in the past by the sector, based on minimum consumption rates, increasing block-rate tariffs, and differentiated according to user groups. In some cases, price cap regulation was implemented.

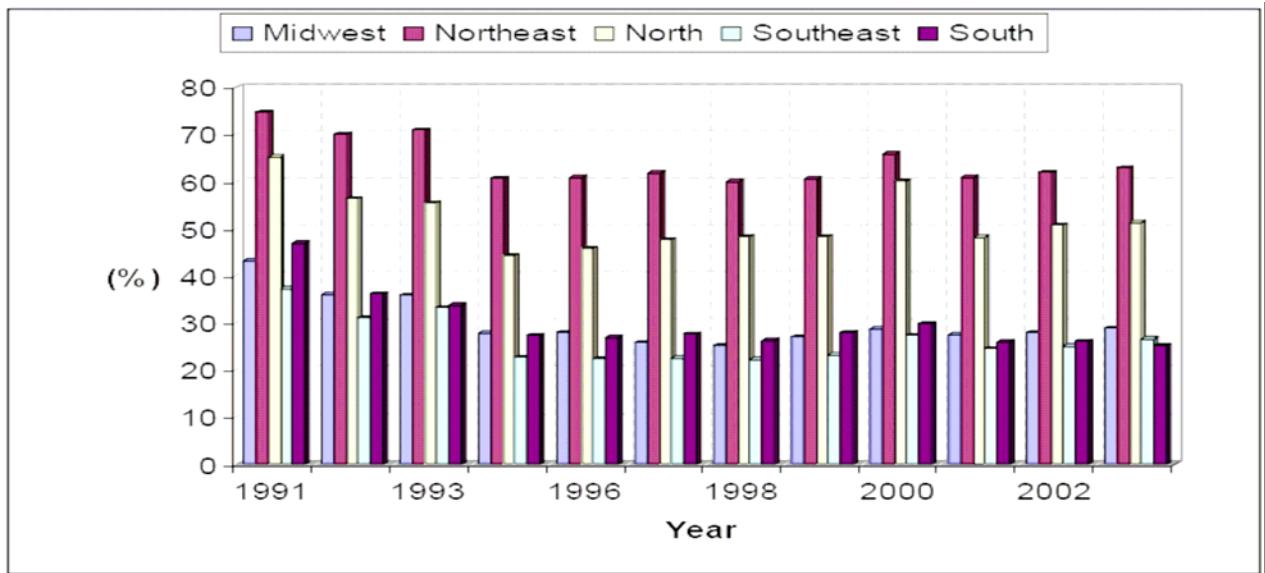
Concessions are the contractual instrument of choice in most cases. The municipalities in the state of Rio de Janeiro that privatized their sanitation services have opted mostly for full concessions (including water and sewage), whereas those in the state of São Paulo have preferred partial concessions and, in some cases, permissions.

The private groups that acquired the concessions were typically comprised of construction companies in the public works business lured into the sanitation market by the possibility of restoring their core business (shaken by the decline in public investments) through their concessions. There were a few cases of concessions granted to consortia of domestic and international companies where the domestic partner was usually a contractor and the international partner was a company with experience in the sanitation business (Parlatore 2000).

3. Social policy and regulation

Despite its abundant natural and human resources and its great potential for economic development, Brazil faces many social and economic challenges. One of them is to promote better income distribution and rescue from poverty a large part of the Brazilian population. As the figure below shows, not only is a large portion of the Brazilian population below the poverty line, but the poverty rate is very unequal across geographical regions. Poverty rates in the North and Northeast regions, around 50% and 60% in 2003, respectively, are much higher than in the Midwest, Southeast and South regions, all between 20% and 30% in 2003. Moreover, poverty rates have not decreased significantly since the mid 1990's in any of the five regions.

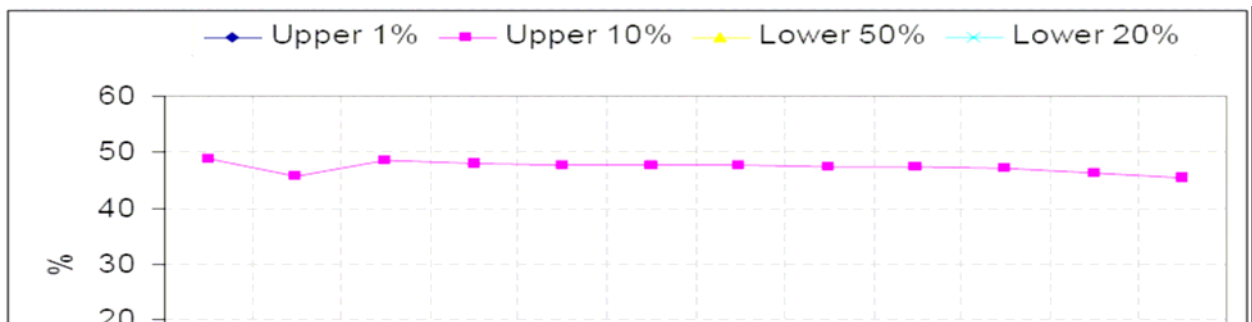
Figure 1: Poverty rates by geographical region



Sources: IBGE – 1991 and 2000 demographic censuses; 1992-1999 and 2001-2003 PNADs

The inequality in poverty rates across regions depicted above, however, is only one facet of socio-economic inequality in Brazil. As can be seen in the figure below, income distribution is also highly unequal.

Figure 2: Share of total income by income class



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