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**Social Policy, Regulation
and Private Sector Involvement
in Water Supply**

Addressing Issues of Equity, Access and Affordability

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Issues Paper and Research Proposal
prepared for the UNRISD Project on Social Policy, Regulation
and Private Sector Involvement in Water Supply

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Issues Paper and Research Proposal

Social Policy, Regulation and Private Sector Involvement in Water Supply

Addressing Issues of Equity, Access and Affordability

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Abstract

This research project intends to investigate how the private sector involvement in water supply deals with poverty issues in terms of access, equity and affordability. It will explore the various social policies and regulation that are intended to help the poor. This research will also investigate the nature of regulatory mechanisms in place and their results. For issues of access and affordability, household data from selected countries and cities as case studies will be used for this investigation. The data (disaggregated in income groups and household expenditure) will also be used in a cross sectional analysis. This paper sets out the context in which this research project will be carried out. It also defines the scope of the research, and develops a methodology needed to undertake this research.

Introduction

It is a well-recognized fact that better public utilities infrastructure (water, roads, telecommunications, port, airport, electricity, etc.) leads to better economic performance. In order to better develop their infrastructure countries have different models in place in terms of the degree of private-public sector involvement for such services. Public utilities infrastructure, especially water, is are unavoidably social in nature and draws such political emotions, like no other issue. Even though water is one of the most crucial elements of life, it has been supplied by the private sector in many parts of the world. Can the private sector guarantee equal access to water to everyone with affordable prices in spite of its profit seeking motives? Can the commercial objectives of the private sector adapted to meet the social needs? This research will explore to what extent the neo-liberal project, imposed by some international and bilateral agencies that developing countries “privatize”² their water supply services is a valid policy as far as outcomes are concerned? The neo-liberal strategies mainly emphasizes on the importance of the market, fiscal discipline, trade, investment and financial liberalization, deregulation, decentralization, privatization and a reduced role of state (Robison and Hewison 2005, p. 185). Certain other strategies such as a limited welfare state, flexible labour market, and restrictive fiscal policies have been given priority over social policies. These strategies are also referred to as the *Washington Consensus*³. Private sector involvement was introduced in developing countries as the linchpin of the Washington Consensus.

It is widely recognized that *social policies* are one of the key elements of development policy thinking in promoting pro-poor development. As a specific case, if social policies in the water supply are well designed, they could help in achieving the environmental, economic and social objectives. However, there are disagreements on which policies are most appropriate and how best to implement such policies. Based on our knowledge and literature review, there seems to be hardly any *serious empirical studies* done to investigate whether the private sector has increased coverage to the poor, or what impact does it has on the poor in terms of affordability and equity.

This research project intends to fill this gap. This concept paper has the aim of presenting a state of the art picture of water supply and sanitation in developing countries. After reviewing literature, some basic statistics on the private sector involvement in water will be presented. Historically, although private sector has been involved in delivering services in some developed countries, the results have not been satisfying. In addition, experiences from developing countries shows that most of the privatization projects are in difficulties and some of them are cancelled. This research project will investigate whether the private sector involvement is the right solution for water problems in developing countries. How can the private sector deal with issues

² Private sector involvement or privatization here refers to all forms of private sector involvement that has commercial objective of making profit.

³ John Williamson (1994) was the first to coin this term, referring to the orthodox economic policies promoted by the US Treasury, the International Financial Institutions, IMF and the World Bank (all based in Washington). It should be reminded that he argued that neo-liberalism should not be synonym for Washington Consensus. However Kanbur (1999) demonstrated that despite its original purpose, critics of Washington Consensus judged what they saw in reality.

of poverty and equity, which include access and affordability. Appropriate social policies may be needed to address these problems. A research agenda is proposed to demonstrate what social policies are most appropriate concerning issues of equity and access. This paper will set out the *context* in which this research project will be carried out. It will also define the *scope* of the research, and will develop the *methodology* needed to undertake this research. It should be reminded at this point, that for any economic reform to achieve its purpose of increasing social and economic welfare to its people, first we need to understand the *theoretical foundations* on which these reforms are based. Secondly, we also need to understand the *local capacity* for undertaking and implementing such reforms.

Current context

Private sector involvement in water is one of the most controversial debates of the development discourse today. On one side are the proponents who argue that since government has failed in providing access to everyone, private sector can solve this problem by using the market principles. Those who advocate the involvement of private sector in water supply (IFIs, bilateral donors, OECD countries, TNCs, professional association and some scholars) argue that private sector will improve efficiency, increase extension of service, bring in more investments, and will relieve governments from budget deficits. It has been argued that because of lack of funding to improve the water infrastructure, developing countries are caught into the “*low-level equilibrium*”, implying low operational efficiency leads to low quality service (Anwander and Ozuna 2002). International development agencies such as the World Bank, regional development banks (Inter-American Development Bank, Asian Development Bank, African Development Bank), and other bilateral donors argue that to break this trap, private sector participation is the solution.

On the other side of the spectrum are those who consider that water is a common good and should not be in the hands of the private sector. They argue that since water is unlike any other resource and because of the fact that water is the essence of life itself, it should *not* be treated like a commodity based on market principles. The private sector cannot apply a just criteria for this basic need. Access to water for everyone then becomes a human right and it is the State’s obligation to provide this vital resource to everyone. This notion of human right goes back to the Enlightenment era where Hobbes (1588-1679) and Locke (1632-1704) had argued that it is the obligation of the State to uphold, protect, promote and enforce rights. But does the State have the capacity to deliver this service to everyone?

And then there is another group who are caught in between these two opposing views. This groups thinks that solutions can be found by considering water as an economic good and a human right at the same right. The truth may be found somewhere here. It is important to set the context in which these debates take place.

The neo-liberals⁴ who believe in free market principles to solve the problem of water have been gaining grounds since the 1970s. This neo-liberal position was given life during the Thatcher and Reagan era (1980s), which was later propelled through the so-called *Washington Consensus* which argued that private sector involvement in public utilities should be a preferred policy over state involvement. After the experience of privatizing water utilities in the UK and other developed countries, private sector involvement was prescribed to developing countries. The results of this policy in developing countries will be presented later.

⁴ The neo-liberal position is based on free trade in free and unrestricted market and private property. It should be noted that arguments in favour of private sector must originate from Adam Smith (1723-1790), who preferred that the private sector should be involved in business and not that State. Later, Hayek (1899-1992) took the relay from Smith’s liberalism and gave it a new intellectual momentum, which became neo-liberalism. However, one small point is that Adam Smith recognized the importance of water and he has reservations that if the private sector was involved in the provision of water, this could lead to unwarranted risks (Smith 1976:33).

The critics of this neo-liberal have generally focused their efforts in demonizing the private sector and the profit seeking motives of large corporations. The private sector responded by proposing (or accepting) certain forms of *corporate social responsibility*. The major opposition which comes from the *rights-based approaches* of water, has been relatively weak in substance and heavy in rhetoric. The main argument that private sector was “superior” to public sector and therefore it should be preferred prevailed. In general, three groups of critics of neo-liberals argument in water supply can be identified for analytical purpose:

- Academics, mainly economists who do not question the private sector involvement *per se*, but criticize the sequencing of the privatization reforms, such as Joseph Stiglitz, Paul Krugman, David Parker, Colin Kirkpatrick, ... This group also calls for better regulation of the private sector involvement.
- Those who believe that the public sector can do the job better if given the resources, such as the Public Service International (which is the global federation of public sector unions), David Hall from PSIRU, Transnational Institute, Polaris Institute...
- Those who criticize it on ideological grounds, which comprises mainly of NGOs such as Blue Planet Project, Public Citizen, and some academics.

What is required here is to put emotions, ideologies and rhetoric aside and provide serious empirical investigation to see if private sector involvement leads to increase in welfare, especially for the poor. This is exactly what this research project intends to do by undertaking empirical research in developing countries and developed countries.

Equity in and access to water services

Issues surrounding water and poverty have now been recognized by the international community as something crucial. All developed economies provide some sort of income support to help the poor afford water supply (OECD 2003a, p. 34). In addition, these countries have also put in place mechanism to help the general population and they have policies targeted to selected groups, such as the poor, large families, older people. These measures include VAT reduction, progressive social tariffs, eliminating disconnections, eliminating annual fixed fees, targeted assistance to poor people such as free water up to a defined volume, forgiveness in arrears, and grants. However, according to OECD (2003a, p. 34) it is argued that the impact of such social policies is limited since the aid is relatively small and the level of poverty

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