

**Thematic Paper – Regulation and Governance**  
**First Draft**  
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**RFQ15. Governance Reframing Question:** *A number of stakeholders have noted that PSP has led to an erosion of democracy and has damaged the relationship between state and community. They have related these impacts to the unequal power relations between large international companies and weak local governments. How can a level playing field be created for negotiations? What are the necessary conditions to create greater social control in decisions around WSS delivery options?*

**RFQ3. Politics of Tariffs Reframing Question:** *Stakeholders across the spectrum recognise that election-year politics often influence tariffs and that PSP can force reforms. How can the process of setting adequate tariffs and collecting revenues be separated from electoral politics?*

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### ***Defining Regulation***

There is no singular definition of regulation; instead it tends to be interpreted in different ways depending upon the perspective and discipline of the interpreter. One description has it that regulation ‘is usually understood to refer to different forms of government intervention into society or, more specifically market-based activities to induce or curtail certain types of behaviour’.<sup>1</sup> Most definitions range in the importance placed on economic and social objectives in regulation.

In *Law and the regulators*, Prosser<sup>2</sup> (1997) states, ‘the nearest thing to a statement of regulatory rationales on privatisation was the first of two reports which the [British] Government commissioned from Professor Littlechild [*Regulation of British Telecommunications’ Profitability*, Department of Trade and Industry, 1984].... According to the report, the primary purpose of regulation is to protect consumers; inefficiency, high costs, excess profits and high wages are only of significance in so far as they lead to higher consumer prices.... Regulation is essentially a means of preventing the worst excesses of monopoly; it is not a substitute for competition.’ For Littlechild at least, purely economic reasons are the driver for regulation. However, Prosser goes on to challenge the stress that Littlechild places on regulating monopoly, and highlights regulation of competition and social regulation as two other important roles for regulators.

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<sup>1</sup> Gerlach & Franceys, 2006, *Regulating Public and Private Partnership for the Poor*, p.3

<sup>2</sup> T. Prosser, 1997, What should the regulators be doing? Chapter 1 in T. Prosser, (Ed.) *Law and the regulators*, p.7. Also cited in Gerlach & Franceys op cit. p.4

Gerlach and Franceys (2006) provide the following summary of literature on the rationale for regulation:<sup>3</sup>

- ‘Instances of ‘market failure’, where regulation is deemed necessary to safeguard public interest objectives, top the list of rationales presented in the literature’ – *Armstrong et al. 1994, Baldwin and Cave 1999, Bishop et al. 1995, Konig et al. 2003, Ogus and Veljanovsky, 1984*
- ‘Situations of natural monopoly, where economies of scale are such that the competitive potential is almost reduced to zero and the market is supplied at lowest cost by a single firm’ *ensure that* ‘regulation is required to control profit-seeking behaviour of private providers or to protect customers from inefficient (or low service standard) public monopolies.’ – *Ogus, 2001, Barker and Cave, 1999, Parker, 1999, Konig et al, 2003*
- There is ‘an economic justification for what has become known as ‘social regulation’’ *in light of* ‘customer’s lack of access to adequate information regarding the service they receive, wider societal concerns and ‘essential’ qualities of certain services’ – *Ogus, 2001*

Also according to Solanes (1998), the justification for having public utilities rests on the notion of natural monopolies i.e. ‘activities involving economies of scale (the greater the scale of production, the lower the unit cost) and of scope (certain types of services are less expensive when provided by one, rather than two firms).’<sup>4</sup> In the case of water and sewerage the industry operates more efficiently as a monopoly, essentially entailing that companies provide a public service as a ‘substitute for the State’<sup>5</sup> requiring appropriate regulation to ensure contribution to the general welfare of the public, and monitoring of the ‘conflict between public and private interests’.<sup>6</sup>

As stated by Jean-Francois Verges in a seminar reported in the Cepal Review, ‘water supply, sewerage and waste treatment services are the oldest public utilities, as old as the city in human history. They remain almost total natural monopolies in contrast to those of electricity, garbage collection, telecommunications or urban transit. Therefore, it is necessary to have strong regulation to compensate the absence of market competition. Water supply, and particularly sewerage and waste treatment, requires, along with urban transport, the highest capital investments of all public utilities: about 25 times annual revenues... Developing countries are trying to make the same effort [to invest] in a few decades, perhaps too ambitiously, given inadequate long-term financing. This only leads to underfinanced systems that provide water for only a few hours a day.’<sup>7</sup>

Despite the overriding importance attributed to the concept of natural monopolies and the primary goal of maximising economic efficiency, it is evident from the literature that regulation has been recognised as a major tool for ensuring that social objectives in

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<sup>3</sup> All authors in four bullet points are cited by Gerlach & Franceys, op cit. p.3

<sup>4</sup> M. Solanes, 1998, The Law for the Regulation of Public Water-Related Utilities, The Water Page, p.3

<sup>5</sup> M. Solanes, op cit. p.5

<sup>6</sup> M. Solanes, op cit. p.3

<sup>7</sup> J-F Verges cited by M. Solanes, 2007, Seminar on the Regulation of Public Utilities “Water and Electricity” Santiago, Chile, October 2005, p.12

service provision are addressed. *The question for many now will be the extent to which regulators can handle the growing complexity of their role.* Particularly when we bear in mind the importance of local context in formulating regulatory strategy.

As will be explained below, traditional models of regulation have fallen far short of their intended targets when copied directly, without inherent flexibility, from the frameworks of services in developed nations. As Eberhard argues ‘whereas independent regulation may in many instances be an appropriate model the credibility and legitimacy of regulation depends on judicious use of hybrid and transitional regulatory models incorporating varying degrees of regulatory discretion that best fit the local country context of regulatory commitment and institutional and human resource capacity.’<sup>8</sup>

### **Box 1**

#### *The case of regulation in South Africa*

According to K. Eales (independent consultant and former Programme Manager for Infrastructure and Services Department, City of Johannesburg), in South Africa the primary driver of regulation in the water services sector is to protect citizens, not providers. However, as has been witnessed with the relationship between the National Energy Regulator of South Africa and Eskom (which provides 95% of electricity used in South Africa according to its company website), the regulator had a mandate to keep tariffs down, ostensibly to serve citizens, but, the unintentional consequence of suppressing tariff increases has been gross under-investment in asset management. A similar scenario, whereby tariff levels are generally pitched below the level required for long-term sustainability, is emerging in the water sector. This is raising important questions about how South Africa’s new water services regulator will view its own role.

### ***Analysing the role and the performance of the regulator***<sup>9</sup>

It is the regulator’s role to define criteria for performance assessment. Overall performance needs to include several factors (e.g. Customer service).

In terms of research, three points should be looked at:

- *What indicators (if any) are being used by regulators?*
- *How do you measure the degree of autonomy?*
- *It is not about public or private; both should be regulated.*

In setting the efficiency goals the regulators should try to make sure that the price is fair in terms of providing services.

<sup>8</sup> A. Eberhard, PPIAF Working Paper 4 2007, p.3

<sup>9</sup> Presented by Richard Franceys, Research Meeting, July 2006

- *Does the regulator have authority to set prices – if not, who does?*
- *How is the judgement on the price made?*
- *How do you improve efficiency?*
- *What incentives should be used to encourage the providers to become more efficient?*

How can regulation help to make water available to poor communities? What special provisions can be made for those with low incomes, pensioners, the disabled or chronically ill? Is cross subsidisation economically viable?

The main criteria for measuring accountability should be designed around participation and transparency of regulatory frameworks. Behind transparency you have many regulatory questions:

- *How often those contracts come to review?*
- *Who pays for the shortfalls?*
- *What are the contractual aspects of regulation?*
- *Can you trust auditors?*
- *What level of transparency is there in terms of the regulatory model? How open is it to civil society?*

Nevertheless, transparency is not easy to measure. Too much documentation might hinder people's ability to analyse the information: it is not about how many documents are available...

There is no way to assess the efficiency of a system without transparency, without data. On the other hand this absence of information might in itself be an indicator: what kind of regulator is a regulator that does not allow people to get information?

Social objectives also need to be included in regulatory frameworks.

- *How are consumers involved in the process/ who is representing different sectors of society?*
- *How do you measure people's drive to become representative?*

## **Box 2**

### *How do you research the efficiency element?*

For example, one could consider that staff efficiency might be a priority to avoid overpayment of services by customers.

But what are the effects of firing people (for e.g. in SA where in some areas 60% of the population is unemployed and where issues of violence are central)? In some countries, people might continue to be paid without working. It also depends on the level of wage: if it is very low than it makes almost no difference to fire employees who might otherwise have benefited from training.

One means for assessing the performance of utilities is by performing comparative analysis, and through participatory approaches with consumers. ‘Some World Bank supported programmes have used score-cards for utility services, an interesting approach. We have applied it to regulators.’<sup>10</sup> Lazzarini reports that in Brazil comparative analysis was applied to develop a methodology comparing the behaviour of seven federal agencies. A ranking was constructed covering 40 parameters including transparency and effectiveness. The issue is as follows: ‘members are asked by governments or regulators or even industry to give a ‘consumer view’ when they have not yet acquired the knowledge and expertise to make such a view comprehensive or ‘expert’. Thus frequently consumers are having to learn their policy as they go along.’<sup>11</sup>

As will be further outlined below, under *Pro-Poor Regulation*, whilst involving customers in assessments of the service they receive may seem a viable way of improving accountability as well as effectiveness, it is not necessarily straightforward to draw out the public voice. However, although the performance of utilities may not be guaranteed by public engagement in governance, it is evident that, whether through surveys, stakeholder councils, or official representation on regulatory boards etc, consumer involvement is certainly an excellent way of improving the regulator-customer relationship.

### ***Regulatory Models***

There are broadly four regulatory models identified by Eberhard:<sup>12</sup>

- Regulation by government,
  - A particular challenge here is the ability of governments to understand the costs and revenue requirements of individual utilities (necessary for economic regulation). Furthermore, there is evident conflict-of-interest presented by governments both managing and regulating state-owned utilities
- Independent regulation
  - Embodying principles of independence of decision making, institutional/management independence and financial independence (as practiced in the UK and US)
- Regulation by contract (as in France)
- Outsourced regulation to third parties
  - E.g. tariff reviews, benchmarking, dispute resolution. There are further sub-variants such as price cap regulation (as in UK) or rate of return regulation (as in US).

Eberhard warns against ‘mantras’ and points to the shift in emphasis within the WB, in this case in the electricity sector, but a similar evolution can be traced in water:

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<sup>10</sup> M. Lazzarini, 2004, *Improving Utilities: Consumer organisations – policy and representation*, p.3

<sup>11</sup> Lazzarini, *op cit.* p.4

<sup>12</sup> A. Eberhard, *op cit.* pp. 10-21

1993: *A requirement of all power lending will be explicit movement toward the establishment of a legal framework and regulatory processes satisfactory to the Bank... This requires countries to set up transparent regulatory processes that are clearly independent.*

2004: *A credible regulatory system requires more than a formally independent regulatory entity... Other transitional arrangements may need to be established... including limiting the amount of discretion that regulatory bodies have in setting prices and key parameters.*

The first three regulatory models described above are relatively familiar. Outsourcing regulation to third parties is a lesser-explored model. Here are some examples:

- Chile has established expert panels as part of its regulatory regimes. Their powers are carefully defined by law and include the remit for resolving regulatory disputes between government regulators and private companies, or between companies in electricity sector. Quinquennial reviews for water tariffs are based on a ‘model company’ approach (see the FEASIBLE model mentioned below). Six of the twenty-one tariff reviews between 2000 and 2004 relied on expert panels (of which only two involved state-owned companies). As past rulings and criteria get carried forward a kind of jurisprudence has developed so that the use of panels has started to decline.<sup>13</sup>
- In Senegal an independent conciliator was used to mediate differences between the asset holding company and the contractor under an *affermage* arrangement. There were 30 mediations between 1993 and 2000. Interventions revolved around performance targets, responsibility for repair, maintenance renewals and tariff revisions<sup>14</sup>
- Gabon did not set up a conventional industry regulator but outsourced key monitoring functions. The conclusions were non-binding<sup>15</sup>
- Bucharest has a standing expert panel to review its private concession agreements<sup>16</sup>

The usefulness and effectiveness of the regulatory models described above is hugely affected by the socio-political environment of sector actors at all levels. Whilst the issue of local context will be highlighted again below in reference to the unsuccessful transplantation of regulatory models from one situation into another, in this instance

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<sup>13</sup> A. Jadresic & L. Bertolini: *Relying on expert panels to settle regulatory disputes. Gridlines Note 22; May 2007 PPIAF.*

<sup>14</sup> S. Tremolet PPIAF 2007, p.15

<sup>15</sup> Tremolet op cit. p.14

<sup>16</sup> Tremolet op cit. p.15

David Hall has also indicated the importance of the interaction between stakeholders' interests in determining the presence of certain models:<sup>17</sup>

Water multinationals, particularly the major ones, do not passively wait for business opportunities to develop depending on supranational and national policies. Rather, they have shown a proactive attitude to interact with key actors on the international, national and local arena in order to facilitate the creation of a favourable environment to private sector participation in water supply and sanitation.

These personal and political connections also extend to European level... Both Suez and Veolia were prominent in the networks of individuals and organisations involved in the World Water Vision promoted at The Hague Second World Water Forum in March 2000, and the Third World Water Forum in Kyoto March 2003. The documents produced by such international fora are then referred to by national policy makers and key stakeholders in relation to specific issues such as pricing, financing, governance, regulation and PSP, not only in developing but also in EU countries.

Another instance in which political environment can be shown to effect regulation is provided by Muller, Simpson & Ginneken (2008):<sup>18</sup>

In 2001, the mayor of Recife, Brazil, initiated a citywide Municipal Conference on water services. This combined selective large neighborhood meetings with a more intense assembly. Four thousand people attended 20 neighborhood meetings and elected 400 representatives for the deliberative assembly over a period of seven months. Of the assembly members, 27 percent represented NGOs, 7 percent were government representatives, and the others were directly elected citizens. The assembly voted on 281 resolutions covering the management model, social control mechanisms, and financial principles. It voted to oppose privatization and to create a municipal Water Supply and Sanitation Council (WSSC) to advise the municipality.

While the general policy decisions of the Municipal Conference have been adhered to, the practical results have been limited, with only 30 percent of the detailed proposals implemented four years later. The limited impact of the conference decisions reflects the complexities of the larger political system.

Muller *et al* go on to explain that the complexities of this system are in part due to a range of uncoordinated participatory consultation mechanisms, as well as the state/local

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<sup>17</sup> D. Hall, E. Lobina, 2007, International actors and multinational water company strategies in Europe, 1990 – 2003, *Utilities Policy* 15 (2007) 64-77, p.72

<sup>18</sup> M. Muller, R. Simpson, & M. van Ginneken, 2008, Ways to improve water services by making utilities more accountable to their users, *Water Working Notes*, No. 15, p.74

divisions of functions for providing water services (a point of contention between various groups), which combine to cause confusion or even conflicting outcomes.

Overall, the success or failure of a utility has been felt to have more to do with structural context and regulatory environment than with ownership. Furthermore, as highlighted by Miguel Solanes, where one thousand different municipalities are providing water individually, how will they be regulated and managed in the best interests of consumers and the nation? Is there a conflict between a national regulatory office and local administration of water services? How can a regulator possibly know all the relevant details of a large number of local services? It is not a coincidence that the modern development of the single sector specific regulator originated in the UK where there are very few water companies – only ten water and sewerage undertakers in England & Wales.

‘The beginnings of utilities regulation in developing countries are usually associated with post-privatisation reforms under the guidance of foreign advisors. Incentive regulation based on England and Wales’ OFWAT model has become a popular export to developing countries’.<sup>19</sup> Overall, Cook et al (2003) note, “blueprints are borrowed, but honoured in the breach more than the observance”.<sup>20</sup>

The above is aptly illustrated by experience in Asia outlined in a report on ADB’s water financing programme where the initial failure of regulatory reforms was in part attributed to ‘transplantation’ of models from the OECD without due consideration for local context, which often encompassed poor governance and institutional issues.<sup>21</sup>

### ***Pro-poor regulation***

One of the key issues facing regulators in developing countries is the common occurrence of widespread poverty and major service gaps, tending to ‘push social objectives higher onto the political – and hence regulatory – agenda.’<sup>22</sup> Whilst the literature warns against ‘capture’ whereby the regulator no longer acts as guardian of the public interest but works in favour of the incumbent, several authors (Cook & Minogue, 2003, Stern & Holder, 1999, and Tremolet & Hunt, 2006) all support a flexible approach towards institutional makeup and regulation in these contexts.

As outlined by Tremolet & Hunt (2006)<sup>23</sup> poor customers raise specific challenges for service provision and regulation:

- They are often serviced by a wide spectrum of operators, which are often informal

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<sup>19</sup> Gerlach & Franceys op cit. p.11

<sup>20</sup> Gerlach & Franceys op cit. p.11

<sup>21</sup> ADB, Enhancing Effective Regulation, 2007, p.1

<sup>22</sup> Gerlach & Franceys op cit. p.11

<sup>23</sup> S. Tremolet & C. Hunt, 2006, *Taking account of the poor in water sector regulation*, pp. 3-4, Water Supply & Sanitation Working Notes, no. 11

- They are more likely not to be connected to the network, particularly if connection charges are high or there are other obstacles to obtaining access (e.g. no land tenure)
- When they are not connected, they often pay a lot more for access to water
- They often have access only to poor-quality or intermittent services
- Their preferences vary widely from one community to the next, but it is often hard for them to get their voices heard by the regulator

Crucially, as noted by Gerlach & Franceys (2006), there is widespread agreement that for privatisation to be successful in improving coverage and efficiency of service to the poor, there must first be good regulatory structures in place. Essentially much of the literature emerging on pro-poor strategies focuses on the need to better understand the attitudes and preferences of consumers, particularly those currently unserved – usually the poor. Thus, whilst Gerlach & Franceys (2006) highlight price regulation, service standards, tariff design, and subsidy allocation as some of the regulatory tasks that can very successfully be adapted, experts underline the importance of involving customers and civil society in driving the adaptations that take place. Refer to Box 3 below.

### **Box 3**

#### *Case study – Empowering communities*

Community-Led Total Sanitation (CLTS) ‘is an innovative methodology for mobilising communities to eliminate the practice of open defecation.’<sup>24</sup> CLTS focuses on behavioural change, preaching the mantra “merely providing toilets does not guarantee change”. The project ignites community awareness over the dangers of open defecation for all, and via visual, practical analysis communities are given a picture of their own sanitation situation and the effects of the chain on them and their neighbours. ‘CLTS is about igniting a sense of impurity, often deeply linked to religious or cultural beliefs, which itself compels people to shift to fixed-point defecation’.<sup>25</sup> CLTS does not provide communities with the hardware to build sanitation but facilitate communities in finding their own solutions and resources, thus inspiring “buy-in” and a sense of ownership.

#### *Case study – Citizen Report Cards*

The 2005 Global Monitoring Report (World Bank) reported that the citizen report card (CRC) is a ‘tool for promoting voice’ and ‘enabling clients to signal needed reforms and... increase accountability pressures through media coverage and civil society advocacy.’<sup>26</sup> They were first launched in Bangalore, southern India, in 1993 and the results were widely publicised. Since this time CRCs have been used in Colombia, Peru, the Philippines, Vietnam, Albania, and Kenya, and they are being developed in many other countries. ‘As a signal from the public sector that citizens’ views are considered

<sup>24</sup> P. Bongartz, 2008, Community-Led Total Sanitation, in Global Future, no.1, p.19

<sup>25</sup> Bongartz op cit. p.19

<sup>26</sup> Global Monitoring Report 2005, World Bank, p.110

<sup>27</sup> Global Monitoring Report 2005, op cit. p.110

important for improving the quality of service delivery and the accountability of providers, these approaches are an important step in the right direction.<sup>27</sup>

Tremolet & Hunt (2006) propose the use of surveys and partnerships with relevant stakeholders as two possible means for collating data on the poor – they stress the centrality of focusing on poor customers and on building the capacity of local communities to represent themselves in the regulatory process.<sup>28</sup> Johnstone et al (1999) recommend that the ‘technical specifications of the contract be consistent with household preferences and their ability to pay for services’.<sup>29</sup> Furthermore, Simpson (2005) stresses the importance of protecting consumers from unfair contract terms, stating that ‘contractual rights should be implicit in that there should be written codification of consumer rights even if individuals are not issues with them.’<sup>30</sup> Nonetheless, there are inherent difficulties in trying to extract the voices and opinions of consumers, as illustrated in Box 4 below.

#### **Box 4**

##### *Challenges for effective customer involvement*<sup>31</sup>

Questions raised:

- What roles should customer representation perform?
- How could the interest of members be sustained, particularly if they are required to perform a wide range of roles?
- How can customer representation and other elements of “water voice system” be adequately funded and where should funding originate from? Should members be paid?
- What should be the relationship between customer committees and any existing consumers associations?
- How can different societies use ideas developed under the England and Wales WaterVoice model without undue politicisation, capture or irrelevance?
- How can the voice of the poorest be heard?
- How independent/separate from the regulator should customer representation be?
- Should customers be represented by (self-selected?) individuals or NGOs or community associations?

<sup>28</sup> Tremolet & Hunt op cit. pp.23-26

<sup>29</sup> N. Johnstone, L. Wood & R. Hearne, 1999, The regulation of private sector participation in urban water supply and sanitation: realising social and environmental objectives in developing countries, p.15

<sup>30</sup> R. Simpson, 2005, Regulatory frameworks for the delivery of public services in network industries: trends and issues, p.4

<sup>31</sup> Gerlach & Franceys, 2004, synthesis report on eConference “Regulating Public and Private Partnerships for the Poor”, p.11

### *Regulation by formula?*

Faced with the difficulty of regulating and supporting a large number of small operators it is easy to see why there might be pressure to develop a general formula to apply in all circumstances. To what extent can judgements about the balance of different budgetary elements be turned into a formula? Would a formulaic approach help to ‘depoliticise’ the issue as is sometimes hoped?

A number of toolkits have emerged to aid policy-making and resource allocation under a banner known by the OECD as ‘environmental financing strategies’ (EFS). These strategies have been piloted using scenario analysis by the OECD in partnership with the Danish Government.

One example of a software tool used to support EFS in the water sector specifically is the FEASIBLE model - Financing for Environmental, Affordable and Strategic Investments that Bring on Large-scale Expenditure – first created in 2001. The model is computerised and can be used, via inputting quantitative data, to simulate the potential financial impact of various policies. In order to use FEASIBLE effectively it is necessary for users to first agree upon their objectives in terms of ‘specific, measurable and time-bound targets’.

The model can be used to estimate the investment, maintenance and operational expenditure of meeting specific targets, as well as to predict the cost of alternative service and environmental targets. Expenditure requirements are directly compared with sources of finance and an annual picture of cash-flow can be generated. This in turn contributes to the FEASIBLE model’s ability to highlight financing gaps and hence ‘help policy makers understand where the main bottlenecks are as well as where, when and what additional policy interventions are needed to facilitate effective financing of infrastructure development programmes.’<sup>32</sup>

FEASIBLE can be used to assess the levels of finance (public, private, domestic, foreign) that might be available under different macro-economic and fiscal conditions. This provides a check on what public budgets might realistically be expected to contribute. FEASIBLE can also help to assess the potential social implications of raising tariffs by determining the impact of price increases on household income.

Originally engineered for application in urban environments in eastern European countries, to apply to African countries, recent work has begun in Burkina Faso and Lesotho to consider the application of FEASIBLE in very different geographies.

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<sup>32</sup> OECD, Methodology and FEASIBLE Computer Model:  
[http://www.oecd.org/document/56/0,3343,en\\_2649\\_34887\\_33719928\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/56/0,3343,en_2649_34887_33719928_1_1_1_1,00.html)

Johan Holmberg of the EUWI Financing sub-group notes the following drawbacks to the FEASIBLE model:

FEASIBLE... is highly technical and quite demanding in terms of data requirements. Its full-scale application takes about a year and requires qualified consultant services. The Finance Working Group will attempt to make it more widely available in Africa by conducting training activities based on the experiences from the country projects.<sup>33</sup>

Such formulae will never remove the element of judgement required in decision-making but they can certainly provide indicators and warning signals. For example, also in the case of OFWAT, there is a formula for what is dubbed the ‘K-Factor’, a price limit set for individual companies determining what that company has to charge in order to finance provision of its service and meet its obligations.<sup>34</sup> The K-Factor is determined by legislation and decision-making related to inflation, but it is essentially regulation by formula. In the newly decentralising environment formulae can therefore assist in the making of decisions and help to make the regulatory process concentrate more on policy decisions rather than technical detail.

### ***Regulating alternative service providers***

There is fast-growing recognition of the important role played by small-scale independent providers in reaching poor and difficult-to-access (not just for reasons of geography) populations. Whereas these providers have traditionally been relegated to the realms of illegality, expanding awareness of the contribution of these providers has forced a reassessment of their legitimate role. However, it has immediately become evident that ‘national-level regulatory tools tend to be poorly suited to the decentralised and dispersed activity of hundreds of small and medium-companies that make up independent operators.’<sup>35</sup> Alejo Molinari (ETOSS, Buenos Aires)<sup>36</sup> argues “small systems are better regulated and controlled by local authorities, but large systems will better perform having an independent regulator, technically staffed.”

For an account of the different types of small-scale service providers and issues around financing them refer to Robin Simpson’s paper on financing of the sector. Refer also to Box 5 for a case study outlined by Ganesh Pangare in recent work conducted on behalf of the Uganda National Working Group.

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<sup>33</sup> Johan Holmberg, email to Hilary Coulby dated 27/03/08 regarding EUWI Financing sub-group activities

<sup>34</sup> OFWAT, <http://www.ofwat.gov.uk/aptrix/ofwat/publish.nsf/Content/informationnote3>

<sup>35</sup> B. Valfrey-Visser, D. Schaub-Jones, B. Collignon & E. Chaponniere – BPD, 2006, Access through innovation: expanding water service delivery through independent network providers, p.24

<sup>36</sup> A. Molinari quoted in Gerlach & Franceys, eConference, op cit. p.6

**Box 5**

*Informal water vendors in Uganda – exert from draft paper by Ganesh Pangare*  
 Pangare<sup>37</sup> reports that on Kalangala Island, located on Lake Victoria, an innovative project has emerged for the provision of local water in two of the local fishing villages. Kalangala Infrastructure Limited, funded by IFRACO (a company operating from London), launched a pilot project to provide water at two landing sites. Via suction from the lake, filtration and chlorination, and finally, pumping into an overhead tank, the water is eventually distributed “by force of gravity”. In Kasekulo village 660,000 litres of water is sold per month at a rate of 2500 shillings per cubic metre.

In order to bring SSIPs into the formal sector careful consideration of their dynamics, financing, operations, and scope will be needed. As Tremolet & Hunt (2006)<sup>38</sup> note, regulators will need to be careful not to “over-regulate” alternative providers so as not to stifle the entrepreneurship and innovation that they bring to the sector. ‘Over-emphasis on technical standards and formal procedures can prove counter-effective by increasing overheads with associated price rises and service deterioration, ultimately forcing independent providers out of business’.<sup>39</sup>

This is illustrated by a parallel comparison with a test performed by the WTO to assess the extent to which a regulation type is actually needed. The “necessity test”, developed by the WTO’s Working Party on Domestic Regulations, if applied to water, would require regulation to be ‘no more burdensome than necessary to ensure the quality of service.’<sup>40</sup> Essentially the test flushes out redundant regulation whose purpose is to protect domestic markets from international interference. Thus, just as in WTO law regulation can be deemed to fail Article 6.4<sup>41</sup> of the GATS, by the same token one could imagine formal concession agreements in turn having rules which might have the effect of forcing alternative providers out of the market or not enabling them to enter it in the first place.

As recognised by Tremolet & Hunt (2006)<sup>42</sup> before actually attempting to regulate alternative providers there should first be an analysis of ‘the potential benefits of establishing a regulatory regime with the actual costs of doing so.’ Given the diversity of types of SSIPs and their approaches it would be necessary to carry out such an analysis on all providers in order to create a strong regulatory framework and a basis for comparability between regulation of network versus alternative providers.

Regulation could be used to address certain aspects of existing services that are unsatisfactory to the customer (e.g. affordability or quality) – there is common complaint

<sup>37</sup> G. Pangare, 2008, Informal water vendors and service providers in Uganda: the ground reality, UWSO, p.23

<sup>38</sup> Tremolet & Hunt op cit. p.20

<sup>39</sup> Gerlach & Franceys op cit. p.15

<sup>40</sup> Gerlach & Franceys, eConference, op cit. p.5

<sup>41</sup> Refer to WTO Website – [http://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/agrm6\\_e.htm](http://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm6_e.htm)

<sup>42</sup> Tremolet & Hunt op cit. p.21

of the high prices SSIPs charge to users. Yet, any consideration of regulating tariffs is discouraged as being risky due to the potential for running operators out of business if tariffs are set below costs.

Other forms that regulation of alternative providers could take include contracts or ‘relay’ regulation (reliance of national regulators on local providers/councils/associations). Another tool, licenses, can help ‘to identify, recognise and oversee IOs... Some view it as an adjunct to regulation; award or renewal of a licence can require such things as a safe source, certain minimum levels of service, periodic testing of water quality, etc.’<sup>43</sup>

As cited by Solanes (1998),<sup>44</sup> Phillips Jr. (1993) outlines four basic obligations for utility licensees:

1. To serve any customer within their service area who is willing to pay for the service
2. To provide safe and adequate service which instantaneously meets demand
3. To serve all their clients without engaging in arbitrary, unfair or undue discrimination
4. To charge no more than a just and reasonable price for services they render

Whilst contracts and licenses provide an inherent form of regulation in the jurisdiction provided by any violation of their terms, they nonetheless require monitoring and management. Currently the literature available on actually how to perform this “light-handed regulation” is limited.

### ***Additional thoughts, conclusions and gaps***

The future of regulation is unclear as decentralisation poses a challenge to the centralised national regulatory offices, which have only recently been introduced in many countries. There is some scope for technical assistance to help with analysis of the variables that must enter into calculations governing tariffs, investment etc, but there are no technical quick fixes especially when so many people remain unserved. There will always be a need for judgement and while some decisions may be short-sighted and partial, in the last analysis WSS will always remain a political issue and rightly so, for there are important public policy decisions to be taken at global, national regional and local levels.

Do we need regulation? – The interesting question of whether we need regulators at all must be addressed. Dennis Mwanza<sup>45</sup> explored whether it would be sufficient to restructure existing utilities in such a way that they attain the (financial) capacity to achieve agreed performance targets to serve the poor. It cannot be assumed that

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<sup>43</sup> Valfrey-Visser et al op cit. p.25

<sup>44</sup> M. Solanes, op cit. p.10

<sup>45</sup> Gerlach & Franceys, eConference, op cit. pp.4-5

regulation is writ, but a careful analysis of why regulation emerged and alternatives to regulation is needed.

- Independent regulators – to what extent can regulators be independent? To what extent is this desirable (this has been touched upon in the alternative providers section)

Some overarching topics – In an eConference on “Regulating Public and Private Partnership for the Poor” in 2004, Gerlach & Franceys lead discussions on the following topics:<sup>46</sup>

1. Regulation, service obligation and the poor:
  - Considering who “the poor” are, what difficulties are associated with providing affordable services to poor communities, how existing services could be extended under the regulatory system to achieve universal access, and factors influencing the long-term sustainability of universal service obligations
2. Customer involvement:
  - How to enable customers to have a voice in service provision – different forms of customer representation and methods of participation
3. Utilities and alternative providers:
  - Existing arrangements of water provision, and how can regulation facilitate cooperation between alternative and monopoly providers, at what level can alternative services be formalised and regulated

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<sup>46</sup> Gerlach & Franceys, eConference, op cit. p.2