

NGI101x - Connecting the dots

This week is about public values, trade-offs, infrastructure performance and regulation. Let us highlight water from this perspective and reflect on the complexity of regulation.

As argued by many of you, water is not a common good. It is a necessary good for everyday life and for economic activity, perhaps even the most necessary one, especially since water is essential for life and public health. The right to water for personal and domestic use to satisfy basic human needs has been protected under international human rights law. The human right to water imposes responsibilities upon governments to ensure that people can enjoy "sufficient, safe, accessible and affordable water, without discrimination". Governments are expected to take reasonable steps to avoid a contaminated water supply and to ensure non-discriminatory access to safe drinking water for all citizens. Today, all nation states have at least ratified one human rights convention which explicitly or implicitly recognizes the right to water, and they all have signed at least one political declaration recognizing this right.

Not surprisingly, there is a huge debate going on on the privatization of water – the debate focuses on the provision of water services, but it may include sanitation.

Opponents of privatization argue that this is incompatible with ensuring the international human right to water, that private sector participation leads to tariff increases and that it effectively turns a public good into a private good.

Proponents of private sector participation argue that privatization leads to improvements in the efficiency and service quality of water utilities. They also argue that it will increase investment and thus contribute to wider access.

The EU is no exception to this debate. Organizers of the very successful 'Right2Water' campaign collected almost 1.9 million signatures earlier this year to urge the EU Commission to guarantee access to water and sanitation as a human right, and to establish legal guarantees that water services will not be liberalized in the EU.

But what do we know about the impact of water privatization? Many examples of best practices and failures can be found. However, statistical studies comparing public and private water utilities show little difference in the average performance. The reality of governance and regulation is not black and white. It is always context and country specific.

From this perspective I would like to highlight two excellent contributions from your fellow-students and then come back to regulation.

The first is about the Water Infrastructure System in India from 'DrMetha'. He writes and I quote:

'India has an enormous governance deficit when dealing with changing water scenarios. Governance of water is divided between the central and state authorities, with

categorization of rules and responsibilities, yet it is seen that the overall sustainable vision for water development, conservation and management remains missing. The coordination and synchronization between departments/implementers and regulators is fragmented leading to each department doing things without much coordination with other departments, and sometime at cross purposes. The regulatory bodies have not been strict in controlling, for example, appropriation of water bodies, industrial pollution, etc. Second, there is lack of data disaggregation and aggregation in important decision making by the body involved in water planning. Data is generated by different bodies and is sometimes contradictory in nature. Overall, there is a weak political will in finding sustainable solutions to water problems and this in turn leads to a governance deficit in water'

The second one is from Pakistan from 'igorfrankey'. His post is also a must read and is titled: 'Water Crisis in a former water abundant country: Pakistan'. It gives a dramatic picture of the extremely precarious water situation in this country. The water infrastructure in Pakistan is on the brink of collapse. This is due to a number of both technical and socio-economic problems. To name a few mentioned in this post:

Water bureaucracy

Increasing trend of urban migration exerting more load on the water resources allocated for urban centers

Inequitable water distribution at micro level and absence of water laws

Inter-Provincial disputes over water claims

Gross underinvestment in basic water-related facilities

Complete lack of attention towards repairing and maintenance of existing infrastructure.

Absence of private sector in any domain of transmission, maintenance and repair which results in no competition and lack of quality control in the water sector.

So, the key questions - also for these examples - are: What are the public values? Is privatization an option? How can regulation ensure that public values are safeguarded in the case of a private water utility? The problems mentioned above are extremely complex.

I will give a few general notions points about privatization of the water sector and the process of regulation.

A private water utility is not disciplined by competitive market forces – it operates a natural monopoly network, so the government retains monitoring and control responsibilities to ensure that its citizens are protected from abuse of market power. In the case of water services, not only the affordability of water, but also public health is at stake. If the privatization of the water sector is only driven by financial constraints, with the purpose of obtaining an inflow of resources to the government, it may be lax in imposing stringent

controls on the private water utility. In the words of Professor Perez-Arriaga, if the regulation is not 'loud' enough, then the long-term infrastructure performance is likely to deteriorate.

Both examples stress the need for regulation, one way or the other. But how should long, loud and legal regulation be organized? You would argue: the regulator must be independent, have the power to impose significant penalties, and the regulatory rules, principles and powers must be firmly embedded in legislation, because regulatory uncertainty would discourage investment. However, in the way regulation is established in practice, you will often see results that seem to be at odds with the clear principles of Professor Perez-Arriaga. A few examples:

First, the need for process bundling.

In general, one can say that - at the institutional level - , the regulator should be truly independent. However, in policy and work processes, the regulator should adopt an outward focus and move into the field. Distance is a dangerous strategy for a regulator, because of information asymmetry. Therefore, 'being there' is a dire necessity. The regulator should work alongside the companies. They should be on committees together, do research together, carry out pilot projects together and conduct evaluations together. In short, process bundling. In this way the regulator will get the information it needs to perform its tasks.

Secondly, strict enforcement of regulation is hard to combine with negotiating and process bundling.

Clear and detailed rules go hand in hand with strict enforcement in the event of non-compliance. However, strict enforcement is bound to provoke tensions with the utility, which is not conducive to smooth negotiations between the regulator and the utility at a later stage. Since part of the regulator's work involves bargaining processes, the regulator will need to strike a balance between strict enforcement and room for negotiations. If the regulator is too strict, then the process bundling will not materialize, and the regulator is bound to suffer from information asymmetry.

Thirdly, supervising compliance with rules and enforcement requires a long lead time. It usually takes some time for the regulator to diagnose an infringement of rules. To enable regulators to operate more effectively, they need to be given more room than the rules allow them. Proactive action is not only desirable, but even necessary. The concept of task competence might be suitable here. It is important that the task description of the regulator guarantees sufficient freedom of action for the regulator.

Fourth, a promising arrangement is the institutional anchoring of standards of decency. Here we are referring to soft rules aimed at realizing values like fairness, openness, honesty, and reliability by the private utility.

The core of institutional anchoring is that intended values are realised by the way the organization is designed, rather than through compulsory rules of behaviour. In other words, incentives should be built into the structure of the organization to make it value sensitive - in order to help the organization exhibit desired behaviour (or renounce undesirable behavior). Institutional anchoring relies on the self-reflexive capacity of the organization instead of frustrating it in the way normal legislation does. It fits in with the growing tendency to anchor good conduct in the philosophy of corporate social responsibility. Of course, there must be a clear commitment - not only good intentions. If need be, the regulator must still be able to apply coercive measures to force the utility to behave responsibly.

To summarize: the reality of governance and regulation is not black and white, - it knows many shades of grey, as combinations of soft and hard rules may often be more effective than just hard rules. In other words, we should add hybrid governance and regulation to the toolkit of approaches to safeguarding public values in the world of infrastructures.

With respect to the water sector, the problem is more complicated: very often, the governance of drinking water infrastructure, water provision for agriculture and industrial water provision is segregated between separate government bodies and regulators, even if the source of that water is the same. On top of that, freshwater provision may be segregated from wastewater removal and treatment, even if they are all part of the same water cycle. Without any form of coordination between the regulators involved, precious water sources are likely to be exhausted or to become polluted, as your contributions have pointed out. The main question here is not whether or not to privatize the water utilities. A public water utility, if it is forced to work efficiently and invest prudently, can also do the job. In both cases, a strong government is needed that clearly articulates the public values to be safeguarded, that sets performance targets, and embeds the rules in laws that can and will be enforced.