

**Asia-Pacific Environmental Innovation Strategies (APEIS)
Research on Innovative and Strategic Policy Options (RISPO)
Good Practices Inventory**

**Public-private sector joint venture for water supply and sanitation services
in Cartagena (Colombia).**

Summary of the Practice

Keywords: Public-private partnership (PPP), water and sanitation, joint venture

Strategy: Improving urban environmental services through private sector participation

Environmental areas: Urban environment

Critical instruments: Organisational arrangement

Country: Colombia

Location: Cartagena

Participants: Joint venture (JV) of municipality and private sector: Aguas de Cartagena (AGUACAR). This joint venture further signed a management contract with Aguas de Barcelona (AGBAR) a Spanish water utility.

Duration: PPP process (1994 to 1995), and a 26-year concession contract

Funding: The initial share capital of AGUACAR was U.S.\$8.8 million, of which 50 percent was owned by the Municipality of Cartagena, 45.91 percent by AGBAR and 4.09 percent by private Colombian investors.

Background:

For over a century, since the 1886 Constitution, Columbia had a two-level governmental system. Following a recent decentralization, Colombia is now a unified state with three levels of government, namely national, departmental, and municipal. There are 32 departments and 1,080 municipalities. The new municipal code of 1986 has now provided for the direct election of mayors, the introduction of local referendums, the fiscal strengthening of local government, decentralization of the administration, and citizen participation in municipal affairs.

The municipality of Cartagena, the largest municipality and capital of the department of Bolivar practices a strong tradition of political favouritism. With an estimated population of 850,000, a budget of U.S.\$177 million and a per capita expenditure of \$208 in year 2000, Cartagena faced investment constraints due to a deteriorating economic situation and growing poverty all over the country with its inequitable distribution of income at the Gini co-efficient of 0.57 (1996). This poverty and insufficient fund allocations from the public sector led to a deterioration of basic utilities.

While responsibility for these basic services was being devolved back to local governments, financial decentralization was introduced to enable municipalities to support their own basic services. The national government raised its priority for water and sanitation after 1995, with a primary goal of 90 percent coverage for water supply (i.e., 90 percent of the population receiving water supply) and 77 percent for proper sanitation, at the cost of \$1.4 billion. It also planned on improving the quality of drinking water, reducing leakages, and bringing in stricter environmental conservation measures. This ambitious plan increased the need of PSP to support these investment and management activities.

Objectives:

The municipality of Cartagena has two major objectives for involving the private sector in the provision of water supply and sanitation services:

- Short-term: To reduce the fiscal burden of an inefficient public service by delegating management functions and improving efficiency by attracting the necessary technical skills from the private sector.
- Long-term: To access loan financing from international financial institutions in order to upgrade and expand water and sanitation systems.

Description of the activity:

1. Privatisation Process

The 1991 Constitution emphasized the importance of efficient public services. New legislation (Law 142), passed in 1994, laid down explicit criteria for efficiency in terms of planning, regulation, and supervision. The government introduced a market approach, which assigned a key role to private capital and technology into the process of institutional reform. This led to PSP in the provision of public services. Article 69 of law 142 also created separate regulatory bodies for water and sanitation, electricity, gas, and telecommunications. Hence a semi-autonomous regulatory body, the CRA, was set up for water and sanitation under the Ministry of Economic Development to promote competition, encourage investment, and prevent abuses by monopolies in order to ensure reasonable tariffs, high quality of services and ample coverage in service delivery.

Moreover, Article 76 of the same law created a public services watchdog (SSP) to monitor the day-to-day operation of the companies entrusted with the delivery of basic utilities through a close liaison with municipal authorities. Regarding water and sanitation, its key roles are to ensure that the regulatory decisions of CRA are followed, to monitor cross subsidies, to hear and decide upon complaints from customers, and to examine corporate financial management. The SSP is empowered to impose fines upon water companies for violation of agreed norms.

The major emphasis, however, was to create joint ventures between the private and public sectors in order to achieve their twin policy objectives of strengthening local government and encouraging PSP. The economic argument for joint venture is that the municipality should retain ownership of the assets, in a manner similar to other conventional concession contracts. As a major shareholder in the joint venture, the municipality definitely has a financial motivation to promote efficiency of the utility.

On the other hand, the political argument also emphasizes that as a major shareholder in the joint venture, the municipality is well positioned to monitor and control the activities of the private sector partner. This is in contrast with traditional concession models, where the public sector effectively hands over control to the concessionaire for day-to-day operations. Nevertheless, criticism from labour unions that this was a sell-out to the private sector was relatively muted throughout these joint venture agreements.

2. PSP in Cartagena water and sanitation:

This was the first city to adopt the PSP for electrical power and for the airport. This was also the first city to introduce PPP for water and sanitation through a joint venture system, through AGUACAR and AGBAR. The municipality holds 50 percent of the shares (300,000 shares), AGBAR hold 45.9 percent (275,478), and other private investors hold about 4 percent (24,522). A 26-year concession contract was signed to operate and maintain these services, and subsequently AGUACAR signed a management contract with AGBAR. The immediate aim was to improve its financial position and efficiency by attracting necessary private sector technical skills.

The initial objective was to secure financing from international institutions to upgrade and expand their deteriorating system. Under the 1995 contract with AGUACAR, the AGBAR was only responsible for management of the system; in 1998, however, the municipality awarded AGBAR a separate contract to manage a major investment program that is mainly financed by the World Bank and Inter-American Development Bank. This was a complex contract, wherein the private sector partner has to carry out functions normally found only in French-style concessionaire models, but with protection from the financial risks inherent in such an arrangement.

According to AGUACAR's reports, the water supply system has increased considerably from 73 percent coverage in 1995 to 90 percent in 1999, and adequate sanitation from 55 to 75 percent during the same period. The World Bank's report, however, suggests that one-third of the poor communities are still without running water and basic sanitation, a discrepancy caused by the location of existing municipal boundaries; most of these poor communities are outside the legal urban boundaries and off-limits to AGUACAR (Box 1).

Box 1. Financial statistics for Cartagena's concession project.

(Figures in million Colombian pesos)	1998	1999
Gross income	61585	57642
Operational profit	10010	11511
Net profit (after tax)	4694	3927
Dividend	1800	2112
Inflation rate	15.7%	9.6%
Unpaid bills	25624	30692

3. Tariff structure:

The figures clearly show a good performance, but also a growing problem of unpaid water bills. This is linked with two major issues. One is the general perception that water is a free commodity; the other is the tariff structure. Although the tariff structure is based on a "pro-poor" philosophy aimed at efficiency and equity, it discourages higher income consumers from paying, because they have to pay more than their own economic share in order to subsidize the poorer communities.

The tariffs are theoretically aimed at generating enough funds to cover operation and investment costs, and there should be an extra provision for cost sharing in the form of a "solidarity fund" to subsidize those in lower income levels. The municipality carries out a systematic survey to separate households in their jurisdiction into six levels, depending on the nature of their house's construction. The 1994 legislation requires that owners of houses at level 4 be assessed at actual costs of operation and capital. Those below that level are assessed a subsidized amount, while the consumers above level 4 pay more to cover the cost of these subsidies.

Critical Instruments

Organisational arrangements

Strengthening Local Organizations through Decentralization

Under the previous system, according to the 1886 Constitution, the president appointed governors to manage all departments. These governors appointed municipal mayors who then exercised control over elected departmental assemblies and municipal councils. The mayor had to play a triple role: representative of the governor, head of the municipal administration, and chief of police. He had to ensure that national policies were being implemented at the municipal level. This centralization gave rise to a strong culture of favouritism at the local level because the criterion for distributing financial support to municipalities was based mainly on the need to secure political allegiance from client groups. This resulted in regional disparities leading to inadequate public services and few opportunities for public participation in decisions affecting the local populations. As a result, according to a 1979 report, the three largest municipalities consumed 72 percent of the total government expenditures with per capita expenditures six times higher than in the smaller municipalities.

In order to avert a popular uprising and growing militancy from guerrilla groups, a raft of legislations was enacted in 1986 incorporating five main elements:

1. The election of mayors
2. The introduction of local referendums
3. The fiscal strengthening of local government
4. Decentralisation of the administration
5. Citizen participation in municipal affairs

Following upon these reforms, a municipality such as Cartagena, with an estimated population of 850,000, a municipal annual budget of \$177 million and a per capita expenditure of \$208 (2000), now elects its mayor and nineteen members of council for periods of three years. This direct election puts pressure on the mayor to carry out projects in the city in order to win votes. International agencies, furthermore, have linked their support to improved efficiency and liberalization of public utilities. As a result, the municipality implemented this public private partnership (PPP) for water supply and sanitation and improved both the management and efficiency of its services.

Impacts

The overall situation is satisfactory both from the municipality as well as from the consumers' point of view. Efficiency of the system has also improved remarkably since 1995 as measured by labour productivity, leakage rates, service reliability, water quality, and customer care. The targets for reducing the financial burden on the municipality as well as for improvements in the technical skills through PSP have also been met, so far. The major target of getting support from international financial agencies to improve and expand the existing system has also been achieved. All of this has been achieved through the joint venture, and it was possible to avoid transferring ownership to the private sector and thus avoid any backlash from the unions.

Lessons Learned

- Cross-subsidies between rich communities and poor communities within the same tariff categories can lead to tariff evasions and non-payment. These cross-subsidies could instead be raised through other taxes such as income tax and property taxes in order to achieve the same target of subsidies.
- The targets for coverage should be stipulated clearly with a short-term division of the overall target to avoid delays and backlogs.
- The boundaries of the municipality, according to the existing contract may not be adequate to cover all urban inhabitants because many of the poor communities are situated outside of these boundaries. Appropriate provisions should therefore be included in the contract to cover all of these communities.
- To avoid backlash and protests from politicians and labour unions, it may be a good strategy to follow Cartagena's example, but, in the long run, this may cause other problems inasmuch as early signs indicate an increased rate of non-payments. This type of concession contract could therefore gradually be converted into a normal concession contract where both appropriate incentives and appropriate risks are given the concessionaire to allow enough of a free hand, in terms of ownership and management, to make these projects efficient and sustainable in the long term.

Potential for Application

The potential for this type of application is high in countries where private sector participation in public utilities is still in the early stages. The municipalities can form joint ventures with the private sector to achieve efficiency, technology transfer and international funding that requires some degree of privatisation and de-regularisation of public utilities.

The other option for potential transfers is the two-tier contract, as we saw in this case. In this case, the municipality formed a joint venture in which it retained the majority of the share holdings for itself. Because the municipality wanted the private sector management to improve efficiency as well as new technologies, it arranged a separate contract with it for that purpose, and this was still part of the joint venture.

Contact

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