



Brazilian Water and Sanitation Sector: Opportunities for Private Sector Participation

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Introduction

Brazilian water and sanitation services provision generally comes from the public sector – 27 state concessionaires and more than 1,300 municipal utilities. Only 32 private companies were granted municipal concessions for sanitation services provision.

The sector's main characteristics are:

- inadequate coverage of service provided, especially in wastewater and treatment – only 49% of the urban population have access to sanitation services and 90% of all sewerage produced are not treated;
- operational inefficiency – an unaccounted-for water average rate of 45%, which measures the combined effects of physical leakage and unauthorised withdrawal;
- poor management;
- overstaffing – an average rate of 4.5 employees per 1,000 connections, which rises to six per 1,000 if outsourced employees are included;
- cross subsidy mechanisms for tariff setting, mainly from metropolitan regions to interior municipalities;
- inadequate metering and billing;
- poor reliability including water quality;
- insufficient internal funds generation for financing the required investment;
- lack of investment for rehabilitation, improvement, expansion or new facilities; and
- poor institutional and regulatory framework.

Although the Brazilian water and sanitation sector's turnover reached US\$5 billion in 1998, it could only

rise to US\$7 billion through improvements in productivity efficiency.

Due to Brazilian economic policies and the financial constraints on increasing the public sector debt, the public sector – states and municipalities – is currently unable to address the pressing needs of the water and sanitation sector. The annual investment required to extend service coverage and quality to adequate levels is US\$2.2 billion over the next 10 years.

But it must be made clear that financial resources alone will not solve the above-mentioned problems. These must be overcome through management (mainly) and the technical skills of experienced service providers.

Thus, private sector participation in the water and sanitation sector turns out to be inevitable.

Main Hurdles to be Overcome

The Brazilian water and sanitation industry's privatisation has already begun. The 32 private municipal concessions granted since 1994 have so far provided services to more than 4.1 million people. However, this movement will only be effective when the state utilities go private.

The 27 state concessionaires represent more than 80% of urban population, own predominantly water and sanitation assets and reflect the existing heterogeneity among Brazil's regions. For example, Brazilian largest state utility represents 38% of the sector's total revenues.

The main hurdles to be overcome for privatisation to be effective in the sector are:

- defining the granting authority in the metropolitan regions, urban agglomerations and micro regions;

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- setting a regulatory framework; and
- establishing a privatisation model.

Granting Authority

Water and sanitation services provision is basically a municipal responsibility according to the Brazilian Constitution. Whenever there is a water facility which only provides services to one municipality, it is this municipality that has the right to award a concession.

However, in the metropolitan regions, there is often a water facility run by the state concessionaire providing services to two or more municipalities. In these cases there is a dispute between the state and the municipalities as to which public entity has the right to award the concession of providing services to those metropolitan regions.

Looking forward to solving this critical problem, the federal government is passing a Constitutional Complimentary Law defining responsibilities between state and municipalities on water and sanitation services provision in the metropolitan regions, urban agglomerations and micro-regions.

Regulatory Framework

The federal government has the constitutional competence to establish the water and sanitation sector's general rules and principles. An Ordinary Law will be passed after the above-mentioned Constitutional Complimentary Law has been approved.

In 1997, Brazil approved a federal legislation establishing the general rules and principles for managing water resources. This Law established provisions for charging for the different uses of water resources. Additionally, in July 1999, the federal government announced the creation of a Water Authority (National Agency for Water Resources – ANA) to regulate the water resources uses.

Many Brazilian states have already created regulatory agencies to regulate and monitor the provision of public services such as power (electricity distribution), gas and transport. The federal government understands that water and sanitation services must be under the jurisdiction of a state-level regulatory agency. It is also understood that the federal government should have a co-ordinating role in the water and sanitation industry.

In 1999, the federal government created the Urban Policies Secretary position directly answerable to the

President. This position's principal attributions refer to urban development, especially in the metropolitan regions. Its main fields are the water and sanitation sector, urban transportation and housing. It will prepare a new Water and Sanitation National Policy that will present the federal government's main objectives for the industry.

The Water and Sanitation National Policy's main objectives are to:

- extend service coverage and quality to the whole urban population living in cities larger than 200,000 inhabitants;
- extend services to the lower-income population;
- invest US\$22 billion over the next 10 years for rehabilitation and expansion of existing systems, new facilities and operational improvements primarily through private sector participation;
- establish a regulatory framework such as the one mentioned above.

Privatisation Modelling

The Brazilian development bank, the Banco Nacional de Desenvolvimento Econômico e Social (BNDES), manages the federal government privatisation programme. Since 1990, BNDES has supported all federal companies' privatisations. After the privatisation of the steel industry, fertilisers, mining and petrochemicals etc., federal public services concessionaires, such as power generators and rail transportation, were privatised.

Due to its expertise, BNDES has been supporting state governments in their companies' privatisation processes. This support may be provided through technical assistance to the state privatisation team or BNDES can act on behalf of the state. Over the last three years, BNDES has supported almost all state-owned electricity distribution concessionaires' privatisations.

Private sector participation in the water and sanitation sector is a federal government priority as it is seen as the principal way to meet the growing demand for services. The federal government intends to give incentives mainly to the states to privatise their concessionaires. However, it must be made clear that the decision on whether to privatise the water and sanitation services or not belongs to the states and the municipalities.

The following privatisation models can be adopted.



Municipal Utilities

Municipal water and sanitation services are generally provided directly by the municipalities. There are few municipal water and sanitation companies (about 15). Thus, the municipal options are to:

- sell the company's shares to a private group if there is a municipal concessionaire;
- maintain the municipal company which awards a subconcession to a private group;
- award a
 - full concession – the private sector will operate the existing systems and build new facilities required to meet coverage services and quality targets and
 - partial concession – this is for building a new facility such as a new water drawing or a sewerage treatment plant

There are no legal or institutional constraints to the privatisation of the provision of municipal water

and sanitation services. The main requisite is the political will.

There is just one concern: regulation. So far, federal government has passed the above-mentioned Ordinary Law and has defined its co-ordination role in the sector's regulation. The municipalities will have two options:

- to create their own regulatory entities; or
- to delegate the regulation of municipal water and sanitation services to a state regulatory agency.

It must be made clear that, in our opinion, the second option should be taken.

It is important to point out that BNDES and Caixa Economica Federal (Brazilian Savings and Loans) have created a special programme – the Public/Private Partnership Programme (PROPAR). PROPAR provides funds and technical assistance to municipalities that have decided to privatise their services. Consultant services are hired to examine the concession's feasibility and to prepare the bidding process.

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State Concessionaires

In the 1970s, the federal government launched a financing programme – the National Sanitation Plan (PLANASA). Through PLANASA, the federal government induced a large number of municipalities to grant their water and sanitation services provision to the state concessionaires then created.

Many municipalities – mostly the capitals of the states – have never formally awarded their services concessions to the state concessionaires, although those state companies have been providing them water and sanitation services.

Nowadays, most concessions – whether formally granted or not – have expired or are going to expire in the next five years.

As a result, there is a clear dispute between the states and the municipalities: which public entity – state or municipality – has the authority or the right to grant concessions? This is the problem discussed above.

Another important issue is a constitutional requirement which establishes that there must be a specific bidding process before a concession is awarded. Many state concessionaires have renewed their concession agreements with municipalities without a previous bidding process.

As mentioned, regulatory framework will be established in the near future. That is because the current absence of rules represents a reasonable risk for those potential private investors interested in the privatisation of the Brazilian water and sanitation sector.

There are four states at present that have decided to privatise their state water and sanitation concessionaires: Amazonas, Bahia, Espírito Santo and Pernambuco.

BNDES will be the manager – will act on behalf of the states – in three of those privatisations: the water and sanitation concessionaires of Bahia (EMBASA), Espírito Santo (CESAN) and Pernambuco (COMPESA).

Aiming to mitigate the main risks related to this sector's privatisation, BNDES' modelling can be described as follows.

There will be a public auction (through a bidding process). The state will sell its share capital in the water and sanitation concessionaire and the municipalities will simultaneously award new

concessions for a 25 or 30-year period to the winning bidder.

BNDES will select and hire consultant groups to evaluate each concessionaire and assess its value. Similar to the way in which BNDES works when acting as a manager of the Brazilian Privatisation Programme, BNDES will work with two different consultant groups, both selected through a public bidding process. They will not only assess all operational systems and assets, legal issues, commercial and financial performance but will also prepare a long-term investment plan associated with an extension coverage services target plan.

As the federal government's main objective is to extend coverage services to all the urban population, our goal is the required investment to improve and expand services. Consequently, we are not looking to maximise the company's selling value.

We foresee serious negotiation between the state and the municipalities on how to share the potential benefits that will be generated through privatisation. It is our intention to focus on the extension coverage and quality targets which will result in the new private concessionaire's investment commitments.

The consultant groups will also suggest the state regulation and will design the regulatory agency, highlighting and legal instruments needed. Before privatisation, the state will pass the necessary laws in order to assure a clear regulatory environment for the private sector.

Conclusion

There is a lot more to say about the privatisation of Brazil's water and sanitation sector, but we must stress that, now, the state concessionaires' privatisation process has most certainly begun.

In the first half of 2000 we will see the privatisation of the first three state concessionaires, and, in the second half of the same year, those private companies will start their investment plans.

So, in January 2001, when new mayors will be starting their governments, they will be able to compare the sanitation services coverage provided by those private concessionaires to those provided by the states' ones. And the present governors, then starting their third year mandate, will also be able to compare their companies' performance to the private ones. When the difference is perceived, I foresee a wave of general privatisation wave in the Brazilian water and sanitation sector. ■