



Policy

research brief

International Poverty Centre

United Nations Development Programme

no. 3
Jan/2007

Privatising Basic Utilities in Sub-Saharan Africa: The MDG Impact

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Introduction

This policy research brief draws on the findings of a UNDP-supported book, *Privatization and Alternative Public Sector Reform in Sub-Saharan Africa* (Bayliss and Fine, forthcoming), to analyse the effects of privatisation on the delivery of water and electricity. Its chief conclusion? Privatisation has been a widespread failure. This has hampered progress on the MDGs for both water and sanitation, and on many other MDGs dependent on energy.

Privatisation has failed on several counts. Contrary to expectations, private investors have shied away from investing in such utilities in the region. So it has been costly for governments to motivate them to invest. Moreover, the focus of investors on cost recovery has not promoted social objectives, such as reducing poverty and promoting equity.

Thus, current realities dictate refocusing on building up the capacity of the public sector. It continues to dominate the provision of water and electricity, and will do so for the foreseeable future. But a dramatic scaling up of both external and domestic resources will be needed to finance more extensive public investment in these sectors. This approach is consistent with the current priority of adopting more ambitious MDG-based development strategies in the region.

The Push for Privatisation

When countries in sub-Saharan Africa became independent, the state dominated the provision of utilities. However, in the 1980s the debt crisis and the ensuing contraction of budgets prompted a re-appraisal of public sector provision. Donors began lobbying for the restructuring of public services; by the 1990s, they were demanding full-scale privatisation. However, implementation of such reforms has been slow.

One of the chief reasons: lack of interest from private investors. After an initial surge, the pace of privatisation slowed markedly. Between 1990 and 2003, less than four per cent of global private investment in infrastructure went to sub-Saharan Africa.

Thus, many governments have had to re-align their expectations. They now focus on creating the *right conditions* for private investors, having put full-scale privatisation on the back-burner. This approach also involves resorting to short-term management contracts with private firms as an interim measure.

The initial hopes for privatisation were so high that donor spending on infrastructure fell in the expectation that the private sector would take up the slack. For example, World Bank lending for infrastructure investment declined by 50 per cent during 1993-2002—with much of this directed towards preparing firms for privatisation. In 2002, Bank lending for water and sanitation projects, in particular, was only 25 per cent of its annual average during 1993-97.

At the same time, the World Bank increased its support for private investment in utilities through its International Finance Corporation and its Multilateral Investment Guarantee Agency. While Bank lending to public electricity utilities dropped from about US\$ 2.9 billion in 1990 to only US\$ 824 million in 2001, its sector lending to private investors rose from US\$ 45 million to US\$ 687 million.

Hence, African countries have been caught in a terrible bind. Not only has donor financing of public investment declined but also private investment has followed suit. Moreover, many governments have had to adopt fiscal austerity programmes, which have led to further declines in domestic public investment in utilities.

Achieving the MDGs

Lack of investment has meant that most countries in sub-Saharan Africa have made little progress towards the MDG target of halving the proportion of people without sustainable access to safe drinking water. They have made even less progress on providing access to electricity, which is the basis for reaching many MDGs, such as the education and health goals.

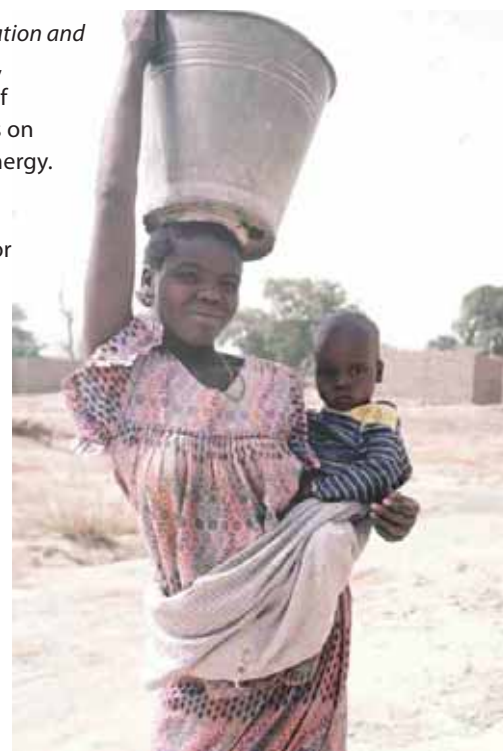


Photo: Ruth Massey/UNDP.

Table 1 shows that in 2004 just 56 per cent of the population in sub-Saharan Africa had access to an improved water source—23 percentage points lower than the developing-country average. A bleaker picture emerges in the electricity sector (Table 2). The proportion of the population in sub-Saharan Africa with access to electricity rose at a snail's pace over thirty-two years—from nine per cent to only 24 per cent. In 2002, over half a billion people in the region still lacked access to electricity, about 80 per cent of them in rural areas. As shown in the table, the other poorest region of the world, South Asia, made much more progress during this period.

Re-Affirming State Provision

As a result of the failure of privatisation, many donors have had to rethink their reform models. In 2004, two influential reports (World Bank 2004; OECD 2004) highlighted the deficiencies of infrastructure privatisation. The World Bank report described the privatisation of infrastructure as 'oversold and misunderstood' and highlighted the need for a case-specific approach. The OECD Report concluded that sub-Saharan Africa had fared particularly badly from privatisation, failing to promote social objectives, in particular.

Both reports put greater emphasis on laying the pre-conditions for successful privatisation. These include the need to ensure good governance, competition and regulation. However, both reports fail to consider seriously the option of strengthening public sector provision of utilities. Where privatisation does not work, the knee-jerk response is to strive even harder to make it succeed—even when the prospects for success have already proved discouraging. A deep-seated ideological aversion to the public sector is probably a major explanatory factor.

The country case studies in the publication *Privatisation and Alternative Public Sector Reform in sub-Saharan Africa* confirm that despite years of trying to privatise utilities, the state remains, by far, the dominant provider of water and electricity. Even in countries where there has been some private sector participation, a strong state has still been needed to monitor and regulate private firms.

Contrary to popular perception, private sector participation does not increase competition. Private investors are interested in risk-free rather than competitive environments. In practice, they often do not compete to win contracts so much as governments compete to attract their investment. When firms secure government contracts, they are frequently given exclusive rights for a protracted period. In Cameroon, for instance, the multinational AES was awarded exclusive management responsibilities for generation, transmission and distribution of electricity for 20 years.

This kind of experience, repeated throughout the continent, suggests that instead of offering lucrative incentives to private firms, the policy priority should be to refocus on building state capacity since the public sector will certainly continue to dominate provision.

The Tanzania experience

The privatisation experience in Tanzania illustrates this point. Although originally an enthusiastic supporter of neo-liberal reforms, the government is now taking back control of the water and electricity sectors. Having put the state electricity

Table 1
Sustainable Access to an Improved Water Source
(% of Population)

Region	1990	2004
Sub-Saharan Africa	48	56
All Developing Countries	71	79

Source: Human Development Report (2006), Table 7.

Table 2
Access to Electricity
(% of Population)

Region	1970	1990	2002
Sub-Saharan Africa	9	16	24
South Asia	17	32	43

Source: World Energy Outlook (2002 and 2004).

utility on the privatisation list for years, the government has recently removed it, largely because of lack of investor interest. When the utility's short-term management contract with a private firm expired at the end of 2006, the utility reverted to public management. Private Sector Participation in this sector has been expensive and inflexible. For instance, the state electricity company plans to take over a major privately owned power plant in order to save money.

Also in Tanzania, the privatisation of Dar es Salaam's water supply began in the mid-1990s. This first attempt collapsed in 2000 while a second attempt elicited only one bid, from a consortium led by the UK firm, Biwater. Although the contract with this firm was signed in 2003, it was terminated 18 months later after no improvement in services. Subsequently, management of the sector was transferred to a specially created public company, under the leadership of a new and effective CEO. Major improvements were evident within the first three months of operation.

The Adverse Social Consequences of Privatisation

The financial difficulties of many state utilities in the 1980s led to a focus on achieving financial sustainability. Attaining social objectives was relegated to a later stage. As a result, poor households have suffered from the reduction in subsidies and disconnection from services when they are unable to pay. Moreover, service delivery has become more fragmented, intensifying inequalities in provision.

Pricing mechanisms

The pricing of utility services poses major challenges in sub-Saharan Africa. In the past, prices were often set below cost. Thus, raising prices has been a crucial step in contributing to financial sustainability. But what costs should utilities try to recover? Covering a greater share of operating costs might make sense. But expecting consumers to also pay for new investment is unrealistic.

Efforts to introduce full cost recovery have floundered because utilities are squeezed between the high costs of their operations and the low incomes of many of their consumers. Costs are often high because many utilities suffer from decrepit infrastructure, caused by the woeful lack of public investment over many years. As a result, system losses are high.

This leads inevitably to imposing unaffordable tariffs on many consumers. A general rule is that water bills should not exceed 5-6 per cent of monthly household income. But statistics for Zambia in 2002-2003 indicate that, on this basis, almost one fourth of households could not afford water tariffs, even those designed for low-cost housing.

While raising tariffs is intended to improve the financial health of utilities, it does not always lead to higher revenue. Consumption can fall if consumers pursue other alternatives. Often these are unsafe and unhealthy. In Malawi, for instance, a 25 per cent increase in electricity prices led to a record use of charcoal even though its production has been illegal since 1997 because of its contribution to deforestation. In South Africa, price increases have led to intensified use of unsafe water sources—contributing to a cholera outbreak in 2000.

Instead of resorting so eagerly to raising tariffs, governments could often reap more gains from reducing system losses. As prices increase, illegal connections are likely to proliferate. Efforts should focus on strengthening the capacity of public utilities to reduce leakages and improve revenue collection. In Ghana, for example, the regulator of the water and electricity utilities has recommended an emphasis on reducing system losses while limiting further tariff increases to those in input costs.

Neglecting the social impact

Typically, the poor pay more for both water and electricity in sub-Saharan Africa, principally because they have to rely on more expensive secondary or tertiary suppliers. Figure 1 depicts global comparisons on payments, which apply to Africa as well. Higher payments by the poor do not imply that they are indeed *willing* to pay more. Policymakers and donors often jump to this conclusion in order to justify higher tariffs.

Poor households have simply had to give up consumption of other vital items. In other words, they already face the worst forms of private provision—paying exorbitant tariffs to small private operators. For example, water vendors operating in slums, such as in Nairobi, can charge 8-10 times as much as public utilities that supply piped water. Thus, for the poor, gaining access to public utilities would be a great improvement.

In addition to worsening poverty, cost recovery can lead to greater inequality, such as across regions. This has been the case in Namibia, where price increases have varied

geographically depending on how expensive it is to supply water. Not surprisingly, price increases have been lower in wealthier regions and higher in poorer regions, due mainly to the availability of water in each region.

This impact is worsened by the elimination of cross-subsidies. In Ghana, for example, rural areas and small towns had benefited from cross-subsidies on water made possible by higher tariffs in larger urban areas. But in preparing for privatisation, the government has eliminated such subsidisation by separating out the more lucrative urban water services. This has jeopardised the financial sustainability of rural services.

Subsidies need to be provided in order to promote equitable access to utility services. Some utilities have introduced 'lifeline tariffs', in which minimal levels of utility services are provided free or at low cost. However, such subsidies can fail to reach the poor because they are often not even connected to utilities. Another alternative is to subsidize connections in poor neighbourhoods.

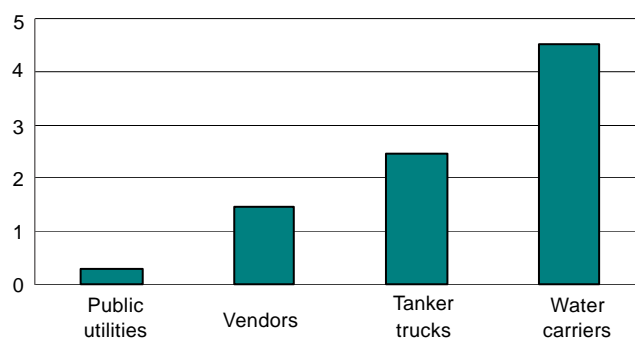
In some cases, such as for water supplies in rural Namibia and in Dar es Salaam, Tanzania, governments have provided small subsidies targeted to poor households. This policy can imply, of course, a labour-intensive process of identifying their needs. Hence, targeting poor areas is usually more feasible. More research is needed to identify the impact of various forms of subsidisation, such as cross, lifeline, connection or targeted subsidies. Most importantly, such interventions need to be integrated into a coherent national poverty reduction strategy in order to be effective.

The Problem of non-payment

A principal challenge for achieving financial sustainability of water and electricity utilities in sub-Saharan Africa is non-payment for services. Some consumers fail to pay simply because they cannot afford to do so. Others do not pay for reasons unrelated to income. In practice, distinguishing between these two groups is difficult.

In Senegal the private provider of water was successful in increasing collection rates by enforcing a strict disconnection policy. But in this case, about 12 per cent of connections fell into disuse within Dakar and higher percentages prevailed outside the city—in some outlying areas spreading to one fifth of all connections. This undermined the gains achieved in improving rates of access.

Figure 1
Payments to Public Utilities Versus Private Providers
 (US\$ per cubic metre of water)



Source: Human Development Report 2006, page 83.

One proposed solution to this problem is prepayment meters. Their success depends on the country and the sector. In Namibia, for instance, such meters have wide coverage for electricity but have been a failure for water. Poorly functioning meters have been disastrous for the finances of some municipal authorities. Often used in informal settlements, many have broken down or been vandalized. For those households unable to afford the charges, the use of prepayment meters amounts to an immediate disconnection policy.

What can be done to enforce payment? Disconnecting services is often used by private providers. Some public providers also resort to such harsh methods. Some consumers begin immediately to pay after being disconnected but many poor households cannot do so. In some countries, such as Namibia, the debts that such families owe to local utility providers continue to accumulate based on accrual of interest, resulting in some cases in eviction from their homes.

The Need for Scaling up Financing

Most of the public providers of utilities in sub-Saharan Africa need substantially more financing, especially for investment in extending service provision. They are trapped in a vicious circle of deteriorated infrastructure, high system losses, high costs and low revenue.

Full cost recovery is not an option for most of the region. As a result of cutbacks in government spending, many water and electricity utilities are operating with ancient infrastructure. Lacking the resources to reduce system losses, they are bound to be inefficient. Their performance improves usually only with an injection of additional investment finance.

Although one of the poorest countries in sub-Saharan Africa, Burkina Faso still has a remarkably successful public water utility. However, this has been due, in part, to large infusions of donor finance. Among all commercialised state water utilities in Zambia, the best performer owes its superiority to having received major external financing for an overhaul of its infrastructure. Even in Namibia, where the state electricity provider, NamPower, makes a profit, additional financing is needed to expand its generation capacity.

In low-income countries, external donors need to play a major role in financing the public investment needed to expand the supply of water and electricity, particularly in rural areas. For example, donors contribute about 90 per cent of the total investment for water provision in Ghana's rural areas and small towns.

If the MDG for safe drinking water and many other MDGs are to be reached in sub-Saharan Africa, external donors will have to contribute the lion's share of increased investment. However, governments will also have to mobilize more domestic revenue for such purposes. It is certainly feasible to expand the relatively small revenue base of many countries. In many cases, this is preferable, on equity grounds, to extracting higher payments directly from consumers. It is also the only long-term financial solution.

Major Recommendations:

- **Invest in Public Utilities:** In sub-Saharan Africa, for the foreseeable future, the state will remain the dominant provider, by far, of water and electricity. Thus, the financial and technical resources currently diverted, fruitlessly, to encouraging private investment should be re-directed to strengthening public-sector capacities.
- **Prioritize Poverty Reduction and the MDGs:** Certainly, improving financial sustainability is necessary for public utilities but not at the cost of social objectives. Because of the high costs and low incomes prevalent throughout the region, heavy reliance on cost recovery is neither viable nor socially desirable.
- **Scale up Financing:** Substantially more funds are crucial for strengthening public-sector delivery of services. ODA needs to be dramatically boosted in order to finance public investment. Additionally, governments should focus on mobilizing more domestic revenue and deploying it to ensure access instead of resorting to unsustainably high tariffs. ■

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Thanks to Tim Kessler, Research Associate, Centro de Investigación para el Desarrollo, Mexico, and Hulya Dagdeviren of Hertfordshire University, United Kingdom for reviewing this Brief. They are not responsible, of course, for its final contents.

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