

## **Co-operation Models for Environmental Infrastructures Projects**

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### **“The role of Private Companies in the management of Public Services”**

**João de Quinhones Levy**  
Civil Engineer (PhD)  
President of ECOSERVIÇOS Group

#### **1 – GENERAL THOUGHTS**

Regardless of which body is charged with managing basic sanitation systems, (water, wastewater and solid waste) the principle should remain the same: that a public service is being performed, which is of particular importance due to its direct link to public health.

Discussing who should be charged with ensuring the service should take second place to discussing the quality of the service. The body which can best manage the service, should be the one managing it. The choice of managing body should therefore be made based on technical and economical criteria, without any recourse to political matters.

In order that conclusions may be drawn, concerning the success of the management model chosen, quality objectives and corresponding efficiency markers should be drawn up previously.

Providing a quality service at an exaggerated cost will be just as undesirable, with regard to the objectives, as providing a low cost, low quality service.

In order to evaluate the quality of the service provided, and to make conclusions regarding the most appropriate form of management, managing bodies must periodically produce reports, which document the quality of the service they provide.

Simultaneously, another body, independent of those managing the service, must monitor results and compare them, as this is the only way to monitor management performance.

The management model chosen can only be judged, in terms of quality, several years after the beginning of operations, by comparing the initial objectives with what has been achieved, based on established efficiency markers.

The founding of managing bodies, whether they be based on public or private capital, of municipal associations or of municipal companies, may not be considered a success in itself, as these bodies are nothing more than tools designed to achieve an objective - to serve well at the right cost.

Just like other countries within the European Union, Portugal is also currently debating which is the best method of managing public systems, as well as who should be providing the service.

This is a question which is often built upon political rather than technical foundations, which forgets the history of institutions and which leaves aside the real objective - to serve the consumer well.

In this article, around which the presentation of this seminar revolves, a synthesis is made of various methods of management, followed by a small history of management systems for basic sanitation services in this country over the last 25 years, analysing the measures taken over this period. The article also discusses the current governmental strategy and defends private participation in the sector.

## **2 - MANAGEMENT METHODS**

The institutional forms of management are as follows:

### A – Municipal Management

#### A.1 – Municipal Services

The technical services of the Council carry out system management. The funds required are included in the municipal budget plan. The personnel used are not specific to managing these services.

This ensures good control of personnel and expense, but on the other hand does not have budgetary flexibility, and does not give priority to the tasks of running the service. Any need for credit is surrounded by much bureaucracy, as is the contracting of personnel and the acquisition of equipment and services. Political intervention into the management is at a maximum, and business-like management is impossible.

#### A.2 – Municipalised Services

The services have administrative and financial independence from the Council, and are managed by an independent board of directors. It does not have corporate personality.

The biggest difficulties come from the fact that it is the municipal authority that must find its own financing and continue to increase staff levels, as well as carrying out their training. The bureaucracy surrounding the contracting of personnel and the acquisition of goods and services is characteristic of the public sector - lengthy and complex.

#### A.3 – Public Municipal Companies

Since 1998, municipal boroughs and municipal associations have had the power to create companies using public capital or with majority public capital. They have corporate personality and autonomy regarding administration, finance and capital.

Management should be balanced, and medium to long term loans must be considered within the limits of the municipal authority's capacity for public debt.

## B – DELEGATED MANAGEMENT

### B.1 – Concession

With this method of management, both construction and running of the service is the responsibility of the concessionaire. Payment to the latter is effected directly by the users of the system.

All management risks are assumed by the concessionaire, who also assumes construction and running costs.

This type of management is particularly used when the municipal authority does not have the necessary capital to construct the systems. The contracts are usually BOT - Build, Operate and Transfer, and the concessionaire does not own the infrastructures.

### B.2 - Leasing

This style of management is similar to the previous model, with the exception that the construction of infrastructures here is the responsibility of the municipal authority. The costs incurred with all system maintenance, including repairs and equipment replacement, are assumed by the lessee. Only costs incurred with building new systems or extending existing systems must be borne by the municipal authority.

The disadvantage with this model is that the municipal authority must request credit in order to meet investment needs.

### B.3 – Service Provision

With this style of management the municipal authority concedes the commercial rights of the systems to a private company. The contracted services must be allotted, as control over the total commercial rights would imply a concession.

The company which provides the services is paid by the municipal authority, which is responsible to the consumers for the management of the systems.

#### B.4 – Mixed Management

This consists of management shared between the private and public sectors. Normally, this involves the founding of a company with joint share capital, whose objective is to manage a particular municipal service.

This is a management model which places the municipal authority on two sides: that of the service and of the consumer, which can lead to a conflict of interests.

An example of this type of management would be municipal companies with majority public capital.

### C – PRIVATISATION

#### C.1 –BOOT contracts – Build, Own, Operate and Transfer

These contracts are similar to the one described under 'concession', with the difference that during the period of the contract the property belongs to the company. These are not yet authorised in Portugal.

#### C.2 – Private Property (OUTRIGHT SALE)

These are also not permitted in this country. With this type of management the company owns the system outright.

### **3 - MANAGEMENT IN THIS COUNTRY**

#### The period between 1977/1990

Portuguese legislation passed in 1977 gave municipal authorities responsibility for managing their basic sanitation systems.

Over this period, the financial efforts made by many boroughs were huge, even with the help of European Community funds. Several municipal boroughs were left unable to invest in other areas, outside basic sanitation systems, especially those boroughs whose services were run with politically-orientated prices below cost levels.

The results experienced on a national level were well below expectations, displaying low service levels, mainly in the areas of wastewater and solid waste treatment.

Statistics from 1990 show that 77% of the population of continental Portugal (94% of the country's population) had running water at home. As regards sewage systems, only 50% of the population's needs were being met, and only 21% of that waste water was being treated.

In qualitative terms, with regard to water supply, 40% of the population with running water experienced good service, 54% had average service and 6% received bad service.

Of those asked, with regard to sewage systems, 25% of the population received good service, 51% had average service and 24% were badly served.

#### The period between 1990/93

In 1990, a new Decree-Law was passed to make the Public Administration responsible for supervising and monitoring the systems.

Despite this new legislation, supervision by the Central Administration remained almost non-existent due to lack of human and material resources. With the lack of supervision and monitoring, as well as the increased cost of system controls, most municipal boroughs did not give due importance to that decree. At the end of 1993, less than 20% were fulfilling the terms of the legislation.

### The period between 1993/99

In 1993, the legislation demarcating sectors was amended, allowing private capital access to the economic activities of water, drainage and wastewater treatment, as well as the collection and treatment of solid waste.

However, in order to limit private activity, the same year saw a new law passed to establish the legal basis for managing and running multi-municipal systems, prohibiting the management thereof by private companies. This law also created 7 multi-municipal companies, to which was granted the majority of the funds of the 2<sup>nd</sup> Support Framework programme. With a high level of contribution, 85%, great investments were made in specific projects, with a limited area of intervention (1 000\*10<sup>6</sup> €). An alternative could have been that of reducing the public spending, involving private companies in the financing, and thereby enlarging the area of intervention.

With the creation of these companies, private bodies believed that the Administration was keeping the most interesting part of the business for itself (high water flow from few clients) and leaving the risky part for them (low water flow from many clients). Despite the criticism, private companies were willing to accept the rules imposed on them which limited their control over municipal systems. They invested around 350\*10<sup>6</sup> € and provided the water services for 1,200,000 inhabitants and sewage services for 1,050,000 inhabitants, according to tables I and II (M. Ramalho, AEPSA 2001).

<b>MUNICIPAL SANITATION SYSTEMS WITH CONCESSIONS</b>	
<ul style="list-style-type: none"><li>• 10 Concessionaire Companies<ul style="list-style-type: none"><li>- 9 include water supply service</li></ul></li><li>• 12 Municipal boroughs<ul style="list-style-type: none"><li>- ± 1,050,000 inhab. (375,000 inhab. in “High”)</li></ul></li><li>• Commitments<ul style="list-style-type: none"><li>- Investments (in 8 Concess.)</li><li>- Leases</li></ul></li></ul>	200,000,000 € (already mentioned)

Table I – Municipal Sanitation Systems with Concessions

<b>MUNICIPAL WATER SUPPLY SYSTEMS WITH CONCESSIONS</b>	
<ul style="list-style-type: none"> <li>• 17 Concessionaire Companies</li> <li>• 27 Municipal boroughs               <ul style="list-style-type: none"> <li>- ± 1,200,000 inhab. (250,000 inhab. in “High”)</li> </ul> </li> <li>• Commitments               <ul style="list-style-type: none"> <li>- Investments (in 9 Concess.)</li> <li>- Leases</li> </ul> </li> </ul>	     150,000,000 € 362,500,000 €

Table II – Municipal Water Supply Systems with Concessions

When private companies were first allowed to become involved in managing municipal systems, it was believed that municipal boroughs would soon choose to concede services as their management model, but this did not happen. The defenders of public management believed that the low number of concessionaires proved that municipal authority was not interested in choosing this path, and that new alternatives should be found - keeping management within the public sector or using mixed management systems.

Defenders of the private sector believe that the lack of interest shown by the municipal authorities was due to the fact that the government never created incentives for such activity, despite having freed the path towards it, and to the fact that the government confused municipal authorities by creating public capital companies with authority over the management of basic sanitation systems.

One aspect is clear, throughout all these ideas: if the consumer is not demanding, if the Administration does not monitor, nor control, then the country's practice will not change.



Why increase the quality and the cost of the service, why introduce new management mechanisms, if the old systems are working and the consumer is not demanding?

At the end of this period, it was seen that the objectives established had not been met, and would not be met by the end of the millennium. At this time, we were still far from the 95% target for water supply, and removal and treatment of solid household waste, and far from the 90% target established for drainage and treatment of wastewater.

<b>RATIO OF COVERAGE</b>			
<b>Service</b>	<b>Situation</b>	<b>Objectives</b>	
	<b>1999</b>	<b>1999</b>	<b>2006</b>
<ul style="list-style-type: none"> <li>• <b>Water Supply</b></li> <li>- Running water</li> </ul>	90%	95%	95%
<ul style="list-style-type: none"> <li>• <b>Sanitation</b></li> <li>- Running Water</li> <li>- Treatment</li> </ul>	70%	90%	90%
	55%	90%	90%

Table III – Situation in 1999

Certainly there are some justifications which could be made, but none of them are capable of denying the evidence. Since 1977 the responsibility for basic sanitation infrastructures has been the responsibility of the municipal authorities, and since 1990 legislation has given the Public Administration the duty of monitoring water quality and wastewater treatment, and has defined the limits and quality objectives, as well as the control and supervision frequency.

The public sector, despite having 100% responsibility for basic sanitation, has not been capable of meeting the targets that it set for itself.

#### **4 – CURRENT POLICY (2000 – 2006)**

The Ministry for the Environment and Territorial Planning (MAOT) has presented a Strategic Plan for this period with regard to Water Supply and Sanitation of Wastewater.

The strategy revolves around the 32 multi-municipal systems, with the public capital company AdP - Águas de Portugal, run by the central administration, being the majority shareholder (51%) in all those multi-municipal associations, each municipal borough itself being a partner (49%).

The state now controls the whole water cycle business, having the funds from the 3<sup>rd</sup> European Support Framework, overseeing the construction and management of systems, running public capital as a business without the help of the private sector.

Even before presenting the definitive version of the strategic plan, the Ministry for the Environment, together with the IPE - AdP, began controlling the municipal boroughs, with a view to founding public capital companies, as concessionaires of the multi-municipal systems, to cover the “lower” part of the System.

In this way, the expectations held for these companies are still being shattered, as the municipal systems market is being taken away from them. Since 1997 they have been operating at a disadvantage over their competitors - companies such as IPE - AdP.

#### **5 – POSITION OF PRIVATE COMPANIES**

Currently, the government's strategic plan revolves around public capital companies, 51% owned by the Central Administration and 49% by the local authorities.

The 32 companies which have been founded cover the majority of the country's population, and the responsibility for managing the "higher" part of the System is therefore with the public sector.

With the "lower" part, distribution and drainage networks, the situation is similar. Through the IPE, the Central Administration holds the companies Aquapor and Luságua, which create the majority of concessions.

The governmental strategy can be summarised as follows: after opening the market to private companies, the current government closed it to managing companies, allowing private companies to be active only in financing.

If private companies feel victimised by the government's current strategy, also in the municipal authorities, there is not total consensus on the matter. Their entry into the market has largely resulted from pressure exerted on them by the structural funds.

As an example of this, the town councils in the district of Évora are founding an inter-municipal company to govern their water and sewage services, as they consider the government-favoured multi-municipal solution to be a form of "expropriation".

The government has been accused of putting pressure on the councils to accept the multi-municipal system which "imposes majority capital holding by the company Águas de Portugal, AdP". As an alternative, local authorities prefer the inter-municipal solution, "with majority capital holding by town councils, but open to other shareholdings".

Besides "taking control from local authorities", the system proposed by the government "involves transferring control to the company founded on municipal assets, at construction cost prices, from which eventual European funds will also be subtracted." Nevertheless, in the event of later privatisation, the assets will be evaluated at market price, according to this municipal authority.

Another local authority spokesperson, from the Town Council of Tavira, upon joining the multi-municipal system in the Algarve, said: "I would have liked to have opted out, but I would have then been unable to make the improvements I wanted to make. I was told that if one opts out, one renounces the Cohesion Fund money."

With this strategy the public administration gains weight, while the involvement of private companies is reduced. Private companies are not invited to help develop this sector, and the whole framework of the state, through Public Administration, public companies, institutions, and other bodies, continues to gain weight.

The government justifies this situation by stating that water supply, sewage and solid waste systems are structural, and therefore should be controlled by the state, in order to guarantee quality service at a low price. This position has not been accepted by private companies for 5 basic reasons.

The first reason is that the country's economy is experiencing reduced growth in GDP and increased inflation. One measure to counter this situation is to reduce the weight of the state. For this reason, it makes no sense to continue to create public capital companies to control water supply, waste, and wastewater. These are companies which will soon become burdensome due to their structure.

If the weight of the Administration should be reduced, these companies should be merely managers, or even give way to the private sector.

The fact that private companies follow the objective of profit, while the public sector is concerned with quality, is another of the reasons used to justify the government's policy. No statement is more false and misleading than this. If we look back several years, to the time when there was only one public communications company, we see that prices were exaggerated. They were so high that as soon as private companies entered the sector, prices began to fall week after week.

Also, for many years, municipal boroughs (local Public Administration) were the only entities responsible for water supply, waste collection, wastewater collection. It was a public service provided by the public sector, but, as recognised by all, very low in quality. The statement that the public sector is a guarantee of quality, then, seems to crumble under this argument.

As regards this aspect of quality, it is worth remembering that a service can only be provided with quality when there are simultaneously three agents representing the three

vertices of the satisfaction triangle: the service provider, the consumer and the supervisory body.

If there is no supervision, the service will not be provided as it should. When contracts are granted to private companies, there are penalisation and controls effected by the concessioner. With the state, experience has shown us that this does not happen. A town council, or a public body, or a public company, is not penalised for poor treatment of wastewater or solid waste, or for bad water supply. As the state does not supervise itself, it is easier to provide a quality service using a private company which *is* supervised, than using the public sector which is not.

The cost of the service is one of the other reasons used to support the existence of public companies in the sector. Theoretically a private company thinks only of profit while a public company can serve better and minimise costs. This is perfectly untrue. Let us compare a contract conceded to a private company by a town council, with a contract between the Portuguese state and AdP. With the former, the private company is obliged to fix a tariff for the next 30 years, based on the investments it makes, which must be itemised. In the contract with AdP, the costs which form the tariff are calculated with no limitations whatsoever - there is no need to check the competition, as there is none. All partial costs considered appropriate are included, and a profit margin of 7 to 8% is added to these costs, calculated by Treasury Bond yield plus 3%. Nevertheless, if it is judged that there is no economic/financial stability, the Portuguese state will allow the tariffs to be reviewed in order to achieve this stability. This means that the municipal authorities are writing a blank cheque to Águas de Portugal for them to manage their systems. It is fair to conclude, then, that prices are more secure within a private contract than in a state contract.

A fourth argument used to justify the existence of multi-municipal systems involves the need to create size. It is true that economy of scale is an extremely important factor with engineering works in the sanitation sector, in that, the bigger the number of inhabitants served by one infrastructure, the lower the cost per inhabitant.

This is in fact a good reason for creating large-scale systems, and it is a reason for creating multi-municipal systems, but it is not justification for systems run by Central Administration.

There is no reason for granted 51% shares in a multi-municipal company to a third party which is neither a client, nor a capitalist which will bring capital. It is merely a company which acts as a managing body. Why should municipal authorities not open the running of the infrastructures to tender contracts, granted to the best company to compete? The situation being created in the country is not one which will best serve the users, as the costs will certainly not be at the lowest, and because there is no reason why decision-making power should belong to central administration, far from the users, instead of being in local hands.

Finally, a fifth justification used to defend the position of private companies is that of profitability, an indicator which highlights the need to create a future for the population. The future of a country is created with companies, which begin small, and which grow. After 10-15 years of strengthening, they eventually become large-scale businesses. In a country where most of the gross national product comes from small to medium sized companies, it makes sense to open doors and cater for the needs of such businesses. Business should be created, these companies should be supported and developed, in order that the rewards can be reaped a few years later.

If these companies do not have profit, no matter how high or low taxes are set, there is no revenue and the country cannot develop.

The environment is one of the factors that can best help the creation of new companies, and the government's policy should therefore be based on creating incentives to business development. This is why private companies have so much criticism for the government's current policy.

Current efforts of the Administration are attempting to control the environmental market, when the overall objective should be to co-ordinate and promote business development.

This development will not restrict the power of the state. Public Administration should be small, made up of experienced staff which do not see private companies as competition, and which co-ordinate and monitor the work carried out by private companies.