

# Regulating Public and Private Partnerships for the Poor



Informal housing, Retiro



Aguas Argentinas,



ETOSS

## REGULATING PRIVATE PROVIDERS: Buenos Aires

The Buenos Aires concession started on 1 May 1993 with Aguas Argentinas as contractor, Ondeo Services as operator. The objectives-oriented contract, to be focused on outputs, e.g. coverage, rather than inputs, e.g. investment, called for 100% coverage of water supply in year 30 and 95% sewerage coverage. It was anticipated that this would require investments of approximately US\$4 billion with a requirement of \$1.2 billion in the first five years.

After steady progress, though inevitably a little slower than anticipated and apparently more costly than some felt reasonable, the economic crisis in 2002 led to a massive devaluation of about 75%. This led to an equal fall in the water tariff which, similar to the currency, had been contractually linked to the dollar. After several years of negotiations and a joint partnership to promote service to the poor there has been no agreement on future tariff levels and investment. Aguas Argentinas has announced its withdrawal

*“Regulation is about sharing power.....”*

# DFID

Knowledge and Research Contract R8320

*Cranfield*  
UNIVERSITY

Case Study:

# ARGENTINA

## KEY FACTS

**Population**  
38 million

**Urban population**  
89.9%

**GDP per capita 2002**  
US \$10,880  
((\$2,050, 2004))

**HDI rank**  
34/177

**Population living < \$2/day**  
14.3%

**Exchange rate**  
\$1 = 2.9 Argentina Pesos

**Urban household water connections**  
76%

**Urban improved sanitation**  
87%

**Water Poverty Index**  
60.9

**Study city**  
Buenos Aires

**Population**  
13,800,000

**Regulator**  
ETOSS (Tripartite Entity of  
Sanitation Works and Services)

**Service Provider**  
Aguas Argentinas

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## Research Summary

Incentive based, economic regulation of monopoly water and sanitation providers is a powerful tool for improving services. Regulators determine the maximum water price ('price cap') to finance a desired level of outputs. Prices in high-income countries have tended to increase faster than inflation as society demands higher standards. The total revenue requirement (from which the price cap is derived) is determined by adding anticipated operating expenditure to planned capital expenditure (for capital maintenance as well as for improvements in quality, security of supply, service standards and service extensions), plus an acceptable cost of capital. Both opex and capex plans include efficiency targets derived from comparisons between a number of providers. Water companies are allowed to retain any further efficiency savings achieved within the price cap for a period (five years for example), an incentive to achieve even higher efficiency, before the benefits are shared with customers in reduced prices for the future.

This model has been adapted around the world with varying degrees of success, usually in the context of a Public Private Partnership, but until recently it has tended to be reactive rather than proactive regarding early service to the poor. There is now a recognised need for adequate economic regulation of public providers, as well as private companies, in lower-income countries, to deliver similar mechanisms for financeability and efficiency and as a prerequisite for developing effective pro-poor urban services.

The purpose of this DFID research project is to give water regulators the necessary technical, social, financial, economic and legal tools to require the direct providers to work under a *Universal Service Obligation*, to ensure service to the poorest, even in informal, unplanned and illegal areas, acknowledging the techniques of service and pricing differentiation to meet demand.

Looking to achieve early universal service, the research also considers how the role of small scale, *alternative providers* can be recognised in the regulatory process. *Customer involvement*, at an appropriate level, is seen as the third key aspect. The research investigates mechanisms for poor customers, and most importantly potential poor customers, to achieve a valid input to regulatory decision-making to achieve better watsan services

within

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### Research Summaries

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# The Water Sector and Institutional Framework

With the ending of the concession there may be seen to be limited value in considering Buenos Aires as a case study. However, the pro-poor aspects have remained a parallel theme in the concession since 1997 and deserve consideration from the point of view of the one-time partners, private company and regulator, and particularly from the point of view of poor consumers.

During the concession period Aguas Argentinas has been monitored and regulated by the 'Tripartite Entity of Sanitation Works and Services' (ETOSS), funded by a 2.67% levy on the tariffs which gives independence from users and concessionaires. ETOSS is managed and administered by a Board of Directors formed by six members, all politicians, representing the Federal Executive, the province of Buenos Aires, and the government of Buenos Aires City. It is therefore recognised to be 'highly politicised' if not 'politically captured.' 'The President of ETOSS, with two votes, rotates every year, which is too short to do anything.

Most of the staff of the Regulator come from the former public operating enterprise. During the first few years of the concession, ETOSS was required to focus on building its technical and regulatory capacity, and to level the playing field in its relations with the concession holder. During this period, relations between ETOSS and the concession holder were complex and strained.' Since then 'a more substantive issue is the degree of freedom allowed Aguas Argentinas in order to meet the goals established in the contract. Conversely the availability of accurate, reliable information continues to be a problem for the regulatory agencies. According to ETOSS, the information provided by Aguas Argentinas during the first two years of the concession was 'poor, incomplete and biased' (Mazzucchelli, 1999). ETOSS now has approximately 140 staff (originally designed for 70) to regulate a single city contract. Each new political

appointee brings their own cadre of staff and tends to leave them behind on departure.

The new concessionaire was quickly able to upgrade water production, both in quality and quantity, and to deliver a continuous supply to the centre of Buenos Aires. Notwithstanding this 'success', the challenge of updating services in a city of this size meant that 1.5 million people remained without a formal water service and over 3.5 million people without sewerage service.

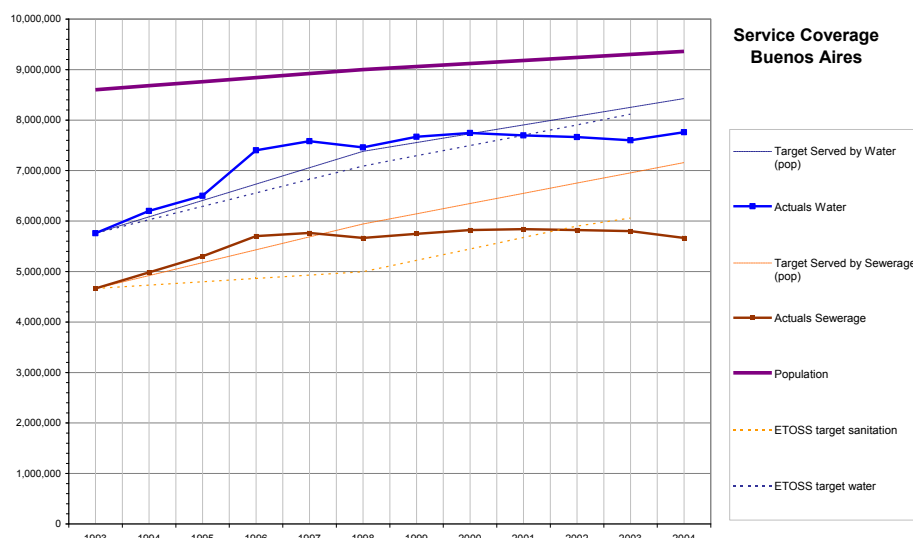
The service targets for water in the new concession appeared to be good news for the poor who had not been receiving water from the public operator. However, for the poorest in informal housing areas, perhaps the hardest to serve, it could mean a wait of nearly thirty years whilst the company extended service to the more commercially lucrative areas.

Although the anticipated investment appeared to start slowly, in the first five years of the concession the company succeeded in transforming the existing assets, staff and facilities, into a modern water and sanitation provider. Water quality now meets international standards (turbidity at 50% conformity in 1993 reaching 98% in 2003 and bacteriological standards from 98% to 100% (Aguas Argentinas, 2003)), water is delivered at an appropriate pressure, customers can contact the company when they wish, problems are solved when reported (client satisfaction at 90% in 2003, *ibid*). Service coverage increased to approximately 85% for water and 63% for sanitation, very much on target. The expectation of \$1.7 billion investment was apparently realised in accounting terms though doubts have been expressed as to the 'value for money' of all that investment.

Then came the financial crisis when in 2001 the Republic of Argentina found it necessary to devalue by 75%, at the same time defaulting on its foreign debts (reportedly \$140 billion). The water tariff, which had

been linked to the dollar, a move which apparently gave protection to the utility against devaluation, was de-linked and therefore reduced, in effect by 75%, relative to the foreign borrowing which had financed much of the increase in fixed assets.

Before this devaluation, the average monthly GDP per household was reported as approximately \$2,500, but 3,100,000 inhabitants had an average monthly household income of under \$500 and 800,000 under \$240. The extent of poverty rose dramatically as a result of the financial crisis. The lower-income groups are located in the informal housing areas,



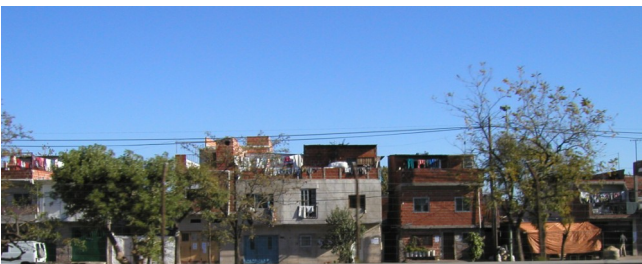


# Service to the Poor and USO

the public housing projects and the outlying developments where it is most difficult to supply utility services and where the people are least able to pay.

Difficulties of supply include distance from water and sewerage mains, thus raising investments costs, informal housing without structured street patterns, illegal occupation of land therefore no security of tenure and a level of insecurity which made the company's staff unwilling to work in some areas.

It is suggested that the high price the poorer, unconnected groups were paying to water vendors led the concession planners to assume that everybody would automatically want to connect. However, the connection fee to receive this low cost service was about \$500 for water (varying according to property land surface, type of soil and percentages of road and pavement work) and \$1,000 for sewerage, representing several months'



Housing on the outskirts of Buenos Aires

household income for the poorest. This was clearly unaffordable. It was also becoming a factor in determining the rate of connections in the Municipalities comprising the outer ring of Greater Buenos Aires where investments in upgrading mains could not be recouped unless lower middle-income customers connected.

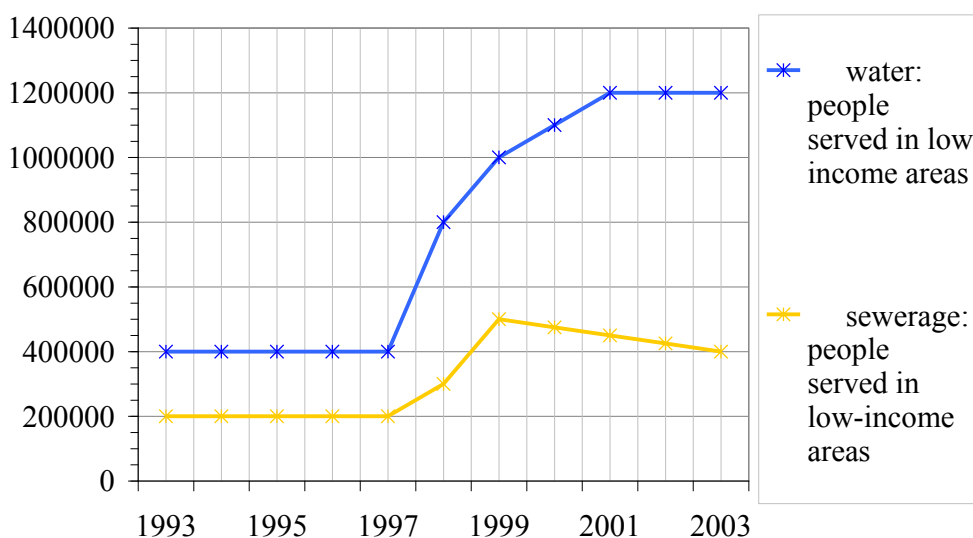
Aguas Argentinas therefore began negotiations with the Regulator, ETOSS, to make the connection fee affordable whilst also demonstrating its commitment to

all customers by beginning pilot projects in different parts of the city aimed at delivering services to the poorest, with the assistance of NGOs. The revised connection fee of \$120 is funded through a cross-subsidy, by a universal charge 'SUMA', since November 1997 at a rate of \$2 bimonthly per lot per service.

ETOSS has to verify annually the compliance with the expansion plans and, if necessary, adjust the value of SUMA (Aguas Argentinas, 1998).

The first pilot project was in the northern part of the city where small slums had developed and where one NGO, IIED-AL, had been trying for some time to improve the quality of life of the residents. Subsequently Aguas Argentinas contracted the skills of that NGO, to the extent of temporarily co-opting some staff into their own business to develop an action plan, to undertake socio-economic mapping of the city and to lead sensitisation programmes for Aguas Argentinas staff. The project also used the resources of the local municipal government, as well as the approval of the Regulator.

Of the one million population of the northern area of Greater Buenos Aires, 822,000 had water connections, 494,000 sewerage. The main objectives of the concession since 1993 had been to achieve an acceptable water supply pressure over the region and to expand the sewerage network with the necessary waste water treatment plant constructed (under test, March 1999). With this work underway, the priority became to help poorer communities to build their own systems. In the low-income neighbourhoods any existing piped services were necessarily illegal, making it difficult to ensure water quality and to receive payment. There were three types of resident, those with ownership of their land, 'non-owners' and by far the majority officially known as 'non urban'.



To serve them, Aguas Argentinas explained, needed a new type of thinking. The recognised service was through water trucks, with often delayed deliveries, for which residents had no means to store the water. Government and the company were aware of the health problems of neighbourhoods that were under-served. They also recognised the wider implications for groups that appeared to have been omitted from formal development programmes. They therefore saw their challenge as

Above left: Reported population served in low-income areas

## USO, Tariffs and Legal Issues

being 'to change the mentality of the people, to show that they were not abandoned, that they are full members of society.'

The 'participative services approach' therefore began in the late nineties based on a partnership with the residents, the Municipalities, the Government and the company.

In this approach, Aguas Argentinas generally designed the projects and supervised implementation, the Municipality funded materials and the residents constructed the system. There were variations to this pattern described below. To promote subsequent payment, a single invoice was given to the community for a year, to see if they were really willing to pay. Meters were installed for the community to limit wastage of water. Typically, one person signed the agreement on behalf of the neighbourhood, often designated by minuted community committee meetings. Aguas Argentinas found that there are leaders in poor neighbourhoods who could help resolve people's problems for them. With the trial year successfully completed, individual billing was introduced, based on an assumption of minimum water usage.

One project, in the Barrio San Jorge (San Fernando County), had 2,300 inhabitants where 71% of households were under the poverty line. 'During the 35 year life of the Barrio there had been eight initiatives to improve water provision, undertaken by different groups, working alone or in some form of partnership. However, the end result was 'a deficient service in relation to socially acceptable standards, low or no community participation in their planning and implementation and lack of awareness for the operation and maintenance of the improvements.'

Under the 1993 Aguas Argentinas Concession



The city expanded outwards along the railway lines leading from the centre

Agreement the barrio was projected to receive services in 20 years time so IIED-AL obtained funds for pilot project from two donors to improve sanitation. Aguas Argentinas decided to give a water service in 1995, just before the elections, 'a period in Argentina where traditionally many things start to work.'

A system of shallow sewers was designed at \$450/household, that is one quarter of usual contractors' costs, funded 60% by the international donors and 40% from the community (through community labour) with a small contractor to lay the mains to ensure quality. 'The effluent collected was initially discharged directly into a nearby river: as a result Aguas Argentinas did not charge for the service. 'When the company network is extended into this area, the collector will simply need to be connected to the mains: the service will then be charged for' (Lyonnaise des Eaux, 1999).

The NGO involved suggested that San Jorge was 'a watermark' for Aguas Argentinas's concession as it was the first case in which the company agreed with a low-income settlement for water provision with special charges and took over responsibility for its operation and maintenance.

It was also a watermark for IIED-AL representing the start of their work with Aguas Argentinas, which subsequently led on to assisting with institutional capacity building for the company including sensitisation of regional managers on social issues, socio-economic and environmental studies, facilitating links and promoting partnerships with other stakeholders. Some in the NGO subsequently regretted the extent of their involvement with a private company.

### Other Partnership Projects

Aguas Argentinas (Lyonnaise des Eaux, 1999) describe how 'The Participative Water Service' Projects were based on 'direct links' between the residents of the area (via an association or 'leader') and Aguas Argentinas. The 'barter' operating method, with the community providing the construction labour, 'was only conceivable for areas where the idea of community work is accepted. 'Bartering' is more difficult with more than 2,500/3,500 residents. Larger areas may be 'divided up' into zones so that this type of project can be applied.'

The UGE (Employment Generating Unit) applied to large-scale projects where the bartering system was impossible. A contractor financed by the province carried out the network extension work under the supervision of Aguas Argentinas. The contractor employed local staff who received \$200 each for (normal) six hour day per month for this 'community work'. The

# Universal Service—Serving the Poor

Provincial Bank paid for materials (as approved by Aguas Argentinas) and the labour through a soft loan. The residents reimbursed the connection charges to the Province over five years for a total of approximately \$200.

Another approach used was the **Tax Credit Agreement**, 'which was based on a direct agreement between Aguas Argentinas and the Municipality. Usually, Aguas Argentinas had to pay a fee to the municipality each time it dug a hole in a public road. This agreement provided the company with a tax credit equivalent to that amount, which was then used to carry out work in disadvantaged sectors. This system actually meant that the connection costs were subsidised by the Municipal Corporation. (Lyonnaise des Eaux, 1999).

Aguas Argentinas believes the pilot projects worked well and were extendable. 'We can improve efficiency now we know how to do it; we can accelerate progress through the new concept of differentiated tariff and materials supplied by third parties and through the education in paying bills. This is very important as low-

For the unmetered domestic customers, average water consumption is a 500 litres per person per day. The President has been saying 'let's aim for 700 litres per person per day'!

income households were given land free, electricity free, all free.'

However, the company also recognised that efficiency was low and that 'the rate of return on the investment is zero or very long term.' But they benefited from the cross-subsidy funding for those new investments, from a reduction in illegal connections and therefore reduced unaccounted for water and from the long-term benefits of converting consumers of water and sanitation services to customers.

The company reported that Government and the Regulator liked the idea of a special reduced tariff and work generation programmes and also the expansion of service: 'we are advancing coverage goals by 10 years.'

One of the keys to their success was the use of an effective NGO as a social consultant as well as a 'civil society' partner. IIED assisted in the preparation of social mapping and socio-economic surveys which led on to a plan for monitoring and assessment. There was a joint IIED/Aguas Argentinas approach with an IIED project manager until the end of 1998 when Aguas Argentinas created the Department for Low-Income Areas and the IIED Project Manager returned to the NGO.

From this experience the company proposed to

formalise two methods: the cross-subsidy and the community projects, with differential tariffs, with contractual basis to make them more efficient and effective. They saw that it was necessary for Aguas Argentinas to adopt to NGO patterns as well as NGO's adapting to the needs of business. The company had to learn that a rapid, quick-fix approach was not always best in low-income areas and that a partnership with NGOs could well be the best way to serve such clients.

By 2001 Aguas Argentinas had served an additional 260,000 low-income inhabitants (Dehan, 1999) through 50 completed projects (involving different patterns of partnership) and had developed its own 'Low Income Areas Department' with considerable experience of meeting the needs of the poorest through a variety of different approaches. By 2004 the company was claiming an additional 800,000 people served in low-income areas (Global Water Report, 2005a).

Following the 2002 financial crisis and the need to renegotiate the contract, with presumed requirements for give and take on both sides, the company agreed to use a Trust Fund escrow account money (from a 7.8% addition to the tariff agreed as a means to fund expansion in 2001). Along with additional funds the plan was to extend water services to the unserved poor in the light of poverty levels which had reached 48% in the country as a whole.

The *Modelo Participativo de Gestion* (MPG) was an attempt to use a participatory methodology 'to find appropriate solutions that involve all the actors of the concession: residents, municipalities, associations, concession regulator, and the company. This model is based on 'informed demand' from the population on the participation of stakeholders throughout the process and on institutional strengthening. Such participation fosters social empowerment, and provides a clearer definition of roles and responsibilities between the stakeholders. It encourages a transition from passive provision and clientelism towards a practice of negotiation. Seen as a continuous process, participation is the key to the continuity and sustainability of the program' (Barbara Chenot Camus, Citizenship and Governability, New School University and Aguas Argentinas, 2004). The initial aim was for 40 projects, including all of the concession's 18 municipalities with the objective to have served 100,000 inhabitants by the end of 2004.

Serving the poor may have been undertaken for 'image and political reasons' by one view or by real commitment of water providers to do the job properly. The company apparently failed to make all the necessary payments to the fund 'for most of 2001-03' but by early 2005 had ensured payments were up to date, the fund



# Customer Involvement

Aguas Argentinas scored their partnership programmes according to participative sustainability, efficiency, effectiveness and replicability. To the question 'why not therefore forget the participatory ideas and concentrate on cross-subsidies' the head of the Low-Income Areas Department emphatically responded: *'No, no, they are all important, we have to have participation of the population . . . a water project should carry much more than water, involving those who were historically excluded . . . participation has a great impact on collection efficiency in 'bad/conflictual' neighbourhoods . . . even though it costs . . . level of participation are always needed . . . but can be graded according to the type of neighbourhood.'*

The regulator also recognised the necessity for more formal customer involvement, particularly in the 2000 review of AA's five year plan for future investments.

ETOSS Resolution N° 42/00 pointed out the constitutional rights under the Basic Law:

- Public participation in the actions of regulators of public services
- Access to adequate and true information about those services.

The regulator explained that a customer services committees system was copied but with 15 to 18 NGOs forming a Customers Commission to represent customers rather than individual customers being involved.

Subsequently, in a document to ETOSS entitled 'Report of the Users Commission (of ETOSS) in respect of the renegotiation of the water supply and sewerage contract ordered by law 25.561', the Users Commission, amongst other issues offered their views on the Aguas Argentinas contract, including advocating termination of the concession contract, placing blame and responsibility totally at the door of the concessionaire. This might not have been particularly constructive.

This approach to customer involvement is seen by some in the city as 'second-best'. In a revised form, the NGOs are required to send one representative to the customer commission, partly financed by the ETOSS budget, meeting every week, with access to all information. 'They can sit in on the board meeting, with no voice or vote, but whatever representations they want can be made. We are obliged to receive them, answer any questions they want, they call me to their meetings to explain and to help them understand.'

As in the England and Wales system it is recognised that customer representatives have to be educated in the realities of the water sector over time. *'They are very reactive, but they are not stupid, you have to respect them, be patient, step by step they start learning, start understanding -- then their resistance decreases, they enrich the process, they have ideas, they have their own rotation, we don't interfere.'*

## Views of Poor Residents, 1999

'We wanted services, we did not want to be looked down upon.' Barrio Resident 'It was a tough project -- the women worked on house fronts, paid for connections to be made well . . . people thought it would be salty water -- then other families joined.'

'We were concerned about police action against us after appealing to the Senator. We have a reputation as dangerous and lazy but it is the Government who does not provide jobs which leads to our teenagers hanging around . . . people are willing to work. Come and talk to us.'

'We started by developing a petition for street lights. 'You are a ghost neighbourhood, you don't exist' we were told. I was angry. Three meetings then ten files prepared before we could be recognised. It took five months. 'The last thing we did was to open the valve on the highway -- they said it was not correct. I said what they did to us was even more incorrect, treating us like animals, with disease. The tanker drivers made us pay again for water, and if no \$10, then no water. They made us hate each other if one had water and another family didn't. Everybody is now paying for water. Some even have TV cable connections! We now pay regularly for water every six months.'

An Aguas Argentinas Engineer commented: 'There is no mathematical formula for this, something you learn by experience . . . there must be a human flow, a family relationship, . . . but she (referring to community representative) is not easy to do business with (said with a smile in her presence). . . but now it is a strong relationship.'

Trying to promote nearness and relevance to customers ETOSS tried to put one representative in every one of the 17 municipal offices, one in each, one from municipality and one from ETOSS. However, *'it didn't work' - customers saw them as messengers, not actually those responsible people and they always wanted to talk to the boss. There were no complaints in two years in the district offices, all complaints came to the head office.'*

There is no direct compensation system for customer grievances. Any fines imposed on the water company for service deficiencies are paid to a separate account

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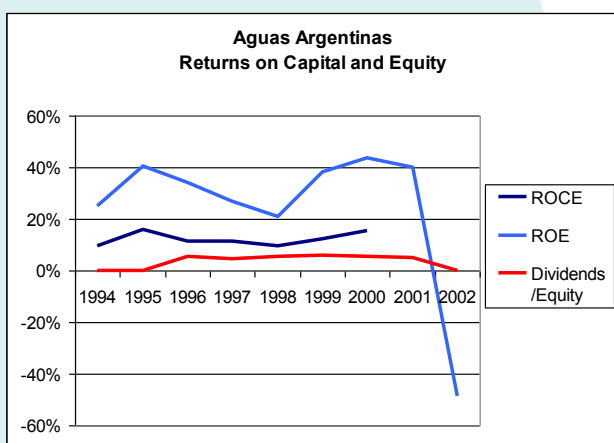
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# Conclusions

In the 1999 words of one of the Regulators: 'the Concession is EXPANSION. If we don't achieve that, no success, quality is not so important. The only measure of success is the universalisation of service, the first objective is urban access to services.' In 1999 AA Dir Gen Adj, Michel Trouseau, also described the main goal of the concession as expansion and maintaining the environment. Clearly this was in harmony with the Regulator, about whom he then commented 'we don't always agree, but the general spirit is positive, we will succeed together.'

Whatever the good words, the regulator is left with the understanding that transfer pricing mechanisms between the various companies of the water providers may well have led to overpricing of fixed assets and the demise of local contractors. Others argue that transfer pricing costs were less than corruption costs when it was a public utility.

The company had explained that 'we have thirty years to make a profit – but if we don't achieve certain financial indicators we will not be able to borrow from banks.' The graph below illustrates the Return on Capital Employed for the company in the early years though much was reinvested. In 1997, Aguas Argentinas, in addition to its management fee, was able to pay its first dividend to shareholders who had initially contributed \$120 million in equity funding. The \$14 million dividend payment was maintained for the following years until the financial crash. Suez Environnement (the French parent company) has had to write off more than \$700 million, but is left with the challenge of servicing a \$500 million World Bank loan for which Suez has guaranteed 70%, with all debts now totalling more than \$600m.



In 2004 the company explained that 'The present targets of Aguas Argentinas are: 1. to maintain the service; 2. to keep staff and 3. to serve the poor'. Has the whole experience been worthwhile? Yes, the quality of service is a high standard, though the pressure is poor and sometimes, the system expansion has gone well. Perhaps it is a matter of a glass being half full or half empty? Though we wanted the glass to be full at this time.

Can regulation, let alone regulation for the poor, work in such an extreme situation? The principles of the 'impartial referee' must be severely stretched, particularly when the Regulators are political appointees. For a while the system continued to maintain service and to promote and deliver services to the poor, whatever the reason. It is unlikely that such progress would have been made under an unregulated public provider. As Ondeo withdraws from Aguas Argentinas some (politicians?) hope that one of its partner companies, who are also involved in the present concession, Aguas de Barcelona (Agbar), will take over operating responsibilities, with two investment funds negotiating the purchase of a substantial stake. Will the new partners be as willing to



Unless otherwise referenced, the information given and all quotes derive from the Business Partners for Development Study Visit in March 1999 updated by the Regulating PPPs for the Poor research visit in May 2004 and subsequent investigations of customer involvement by Barry Walton during 2005. Other References are listed on page 7.

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