

Legislative reform for Brazil's water and sanitation sector could present a win-win scenario for users and investors

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The Brazilian Congress is debating a new legal framework for the water and sanitation sector. There are high hopes that, if approved, it will be a game change that will improve the lives of 35 million Brazilians without access to potable water and more than 100 million without sewage collection services.

There is empirical evidence that the productivity of sanitation companies with total or partial private equity tends to perform better than when they are entirely state-owned. In recent months, it became clear for most decision makers in Brazil that it is imperative to attract private capital to the Brazilian water and sanitation industry in order to enhance the governance of the sector and to provide financing to the investments still needed, which cannot be sustained by the exhausted public treasury.

The bill of law under scrutiny correctly identifies one of the bottlenecks for this attraction: fragility and regulatory fragmentation. Investors feel insecure because, as it is now, any municipality can establish its own regulatory agency, which hardly ever has technical competence and decision independence to calculate the tariffs necessary to maintain the economic-financial equilibrium of the concession. This is very different from the Brazilian electric energy sector, which has a single regulatory agency for the whole country (ANEEL) and has already managed to make the service available to practically all Brazilians.

In order to address this problem, the bill of law assigns to the Brazilian Water Agency (ANA) the responsibility to establish the "national guidelines for the regulation of the provision of public basic sanitation services". In many ways one can foresee an improvement in the quality of service and fairness in the tariff calculation. One example is that household owners will be obliged to connect their property to the sewage collection network, whenever available. Also, the connection will be free of charge for low-income families and the corresponding cost will be included in the tariff calculation, providing a justifiable cross subsidy among users. After all, the beneficiary of sewage collection and treatment is the whole community, rather than any specific individual.

ANA will likely enhance the currently adopted regulatory methodology in many other ways. For example, municipal or state regulatory institutions often encourage higher productivity by allowing the corresponding benefits to be allocated during a few years to just the shareholders. However, after a reasonable lapse of time the benefit needs to be shared with the users through a tariff reducer, often called "factor X", which was adopted by the English regulator Stephen Littlechild in the 1980s.

When there is already the infrastructure to provide full service to the entire population, as was the case in England, or today's Brazilian electricity sector, it makes sense to seek continuous tariff reductions. However, this regulatory view sees only two groups with conflicting interests: on the one hand, the users, interested in quality services at the lowest possible cost; on the other, the shareholders of the service providers, interested in the highest possible profit. When the service is not universalised, such as sanitation in Brazil, there is a third group that is insufficiently considered in the theory of economic regulation: those without services.

Public services are funded by tariffs paid by users and taxes paid by taxpayers. If the taxpayer's share must decrease due to the fiscal crisis, the user's share must increase. For sure, higher productivity could help. But in general, it is not enough to avoid a tariff increase following the entrance of a private company because the invested capital needs to be remunerated and depreciated. Therefore, higher participation of private water and sanitation companies in developing countries, like Brazil, imposes some political, public relations and technical challenges that, if neglected, can result in failure.

On the other hand, if these challenges are properly addressed, private companies can get high return on investments and, at the same time, improve significantly the lives of millions. In other words, it can be a win-win game.

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