

Management Strategies and Institutional Barriers: An Analysis of Public-Private Partnerships in Water Management in Metro Manila, Philippines

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Introduction

Faced with a high debt load, an ageing water system, and a rapidly growing city, the government-run Metropolitan Waterworks and Sewerage System (MWSS) of the Philippines was ill-equipped to provide service to the city of Manila. In the early 1990s, bolstered by its efforts in privatizing the energy sector, examples of seemingly successful public-private partnerships (PPPs) for water in other developing countries, and the global enthusiasm for private sector participation (PSP) in infrastructure and utilities, the Filipino government examined options for involving the private sector in water provision (Dumol 2000; Fabella 2006; Riedinger 1994).

The government split the city into two zones, and signed concession agreements with private consortia to provide water and sanitation services. The concessionaires, Manila Water and Maynilad, had vastly different corporate outcomes: the former has achieved high levels of coverage and service, while the latter has reverted to temporary government control and will be bid out to a new company. This

contentious privatization history has been chronicled by many researchers (see Montemayor 2005; Dumol 2000; Chavez and Malaluan 2005; Rosenthal 2001), since the results in the two zones differed so dramatically. In this paper, I argue that the differences were due primarily to the interaction between three key factors: the Asian currency crisis, debt allocation in the contract design, and internal management strategies. Despite similar social and regulatory environments, Maynilad was unable to achieve the level of success of Manila Water as a result of the interplay of these three elements.

This paper consists of three sections: the first analyzes how the contract-dictated debt allocation led to problems during the currency crisis. The second section examines the effect that internal management strategies had on the companies' abilities to cope with problems. The third argues that, while the regulatory structure was not ideal, it should not be considered a primary reason for contract failure. However, this last section also notes that a different regulatory structure might have mitigated some of the problems. The conclusion offers general recommendations for water provision contract design and management, and speculates on what the outcomes in Manila might be had the zones of the companies been reversed.

Debt structure and tariff limitations

The debt structure has been cited by Maynilad as a significant factor in its contract failure in Manila (Esguerra 2003). In addition to other fac-

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tors, the currency devaluation did present a barrier to the company's operations. The unequal division of debt was intended to balance the need for capital investment across the two zones, since the East Zone had less existing infrastructure. The contract designers assumed that Manila Water would have a greater need for immediate investment in expanding the system (IFC 1996); however, the initial analyses underestimated the investments in repairs that would be needed for the existing pipes in the West Zone.¹

The Asian financial crisis occurred in 1997, only a few months after the contracts had been signed (Radelet et al. 1998). The value of the Philippine peso in relation to the American dollar dropped by half, which effectively doubled the dollar-denominated debts carried by both companies (Esguerra 2003). Even in a stable economy, the apportionment of 90% of the debt to Maynilad would have posed challenges, but this currency devaluation was a crippling blow. Prior to the financial crisis, the company had been struggling to secure adequate funding, and had not yet received long-term investment. The sudden change in its financial standing resulted in an inability to attract stable investment apart from a series of bridge loans.²

The contract included processes for tariff adjustments and rate re-basing (Inocencio and David 2001), but the allowances in the agreement were not sufficient for a change of the magnitude experienced in the Philippines. The companies had agreed to a condition where they could recover currency losses over the length of the contract, instead of recouping them immediately.³ In retrospect, this compromise was not prudent, and contributed to Maynilad's inability to continue its operations. Manila Water's lower levels of debt and greater levels of secured financing meant that it was better able to withstand the currency crisis.

One problem faced in tariff setting and adjustment is that there are strong social pressures—either real or perceived—for tariffs to be kept low. This can be attributed in part to the

view of water as a human right (Razzaque 2004). In general, an unwillingness to set appropriate tariff levels for cost recovery constrains an operator's ability to attain economic viability. During the currency crisis, the private utilities in Manila could not turn to the government coffers to cover the additional debt. Their only recourse for recovering losses was higher tariffs, but that path was limited by the constraints of the contract.

Internal management strategies

Manila Water faced some initial tension between the former MWSS employees and the new private sector employees. However, once they completed their restructuring strategy, these conflicts subsided, and the decentralized structure proved to be effective. The horizontal structure of management meant that managers were given substantial autonomy, which increased the company's efficiency and local accountability. Flexible responses within the company were therefore possible, which allowed for context-appropriate responses to problems in specific neighborhoods (Zerah 2000).

In contrast, Maynilad initially focused on contract requirements rather than corporate structure. By doing this, it ended up with longer-term problems of burdensome bureaucracy and inflexible problem solving mechanisms.⁵ Less autonomy also meant that there were fewer areas in which individuals could make substantive changes, which did little to encourage an environment of innovation, productivity and efficiency.

The Manila Water strategy of decentralized authority and managerial autonomy provides incentives to individuals within the system (Beer and Weldon 2000); thus even when there are external shocks, adaptive behavior at multiple levels is possible. The experiences of Maynilad and Manila Water provide support for the claim that internal reorganization and good corporate management are critical factors for reform success. Privatization (or corporatization,

regardless of the public or private status—Smith 2006) does not equal good management; there need to be mechanisms to allow for a transition from government to corporate management that specifically facilitates their integration. This is particularly important when companies are awarded contracts to provide essential services like water.

Regulatory system independence

While an independent regulatory board in Manila might have mitigated trouble more effectively, it would not have prevented the problems resulting from the interaction between external shocks and internal management. Moreover, the problems with the MWSS Regulatory Office (MWSS-RO) may not have been the form but the composition. That is, it may not have been the lack of independence of the regulatory office that hindered decision-making powers, but instead the lack of training and experience of the appointed officers. Conflicts between the regulatory officers caused further problems with reaching and abiding by regulatory decisions.

A legislatively-created regulatory agency, rather than one established through a contract, might reduce problems with political interference in regulation in developing countries; however, independence does not necessarily quell fears of regulatory capture, nor does it ensure that parties find the regulatory decisions fair and prudent. Although the concession agreement in Buenos Aires was regulated by an independent agency, the contract still became mired in political and financial controversy (Loftus and McDonald 2001).

Regardless of the independence or subsidiary nature of a regulatory board, it could be beneficial to have a “shadow regulator,” from a country with effective water management, to help with the transition to a corporate water provision system.⁶ This shadow agency would monitor the regulatory processes, and would be

able to advise or step in when problems arise. While regulatory processes were a contributing factor to the problems in Manila, contract failure in the West Zone should not be attributed to poor regulation.

Conclusions and implications

Despite apparently similar social, political and regulatory conditions (IFC 1996), Manila Water and Maynilad realized very different contractual outcomes. The differences that allowed Manila Water to emerge from its troubles more successfully than Maynilad were primarily contract design, debt allocation and the effects of the currency devaluation, in conjunction with dissimilar management strategies.

An illuminating thought-experiment in this situation is to speculate whether Manila Water would have been better able to cope with Maynilad’s situation. While it is difficult to determine the relative magnitude of the roles of management and financial problems in leading to the contract outcomes, it is plausible that Manila Water would have been better able to recover than Maynilad. Management practices would not have prevented the impact of the currency fluctuations on debt loads; however, different managerial approaches might have changed the financial decision-making processes and expenditures in the early stages of the contract. Moreover, the interactions with regulators might have been less antagonistic in light of different personalities. In the opposing situation, it is unlikely that Maynilad would have realized similar successes to those of Manila Water in the East Zone, given its internal conflicts. While the situation might not have culminated in contract failure, as it has in the West Zone, Maynilad would have been unlikely to replicate Manila Water’s success in securing financing and improving service.

Given that the negative effects of currency fluctuations have been seen in several utility privatization agreements (Bayliss 2002; Davis 2005; Rodríguez-Boetsch 2005), there needs to be

greater explicit recognition of the effects that economic shifts can have on utilities' cost recovery and debt repayment. This may involve allowing temporary increases in tariffs, short-term government assistance, or requiring parent companies in consortium agreements to use their assets to cover costs. Potential risk mitigation mechanisms include insurance against currency losses and escrow accounts that provide a source of funding during crises. This latter approach might require that governments allow companies to charge higher-than-normal water tariffs, so that they can put aside these funds.

Increased communication with water users might allow the community to better understand the expenses associated with running water services. This might result in an environment where consumers were willing to allow temporary tariff increases, as they would not feel that increased prices were leading to increased profits without providing better service. Removing tariff-setting from the political realm, where it may be a contentious issue for politicians worried about attracting votes, could be beneficial for setting more appropriate water prices. The concerns about high tariffs for the poor could be addressed through cross-subsidies, alternate arrangements for specific neighborhoods, or income transfers outside of the water sector.

A different type of regulatory agency might have been more effective in dealing with the crisis and might have been able to establish mechanisms to mitigate the problems; however, even better regulation likely would not have overcome the management and financing problems experienced by Maynilad. While conceding to tariff increases earlier in the process might have been beneficial to Maynilad's ability to secure financing, the company's problems were not exclusively financial; moreover, even independent regulation would not have altered the uneven debt structure which contributed to the problems experienced by the company.

The lessons learned from water sector reform efforts will need to be understood as

urban centers grow and water scarcity intensifies. While a rulebook for developing water provision systems is not advisable, since appropriate natural resource management is context-specific (Merrey et al. 2005), it is important to identify processes that facilitate flexibility and accountability. The cases in Manila suggest that greater awareness of global financial market impacts on water utilities is necessary, and that specific insurance mechanisms may be needed for the water sector. Moreover, they illustrate the importance of focusing on good management for water utilities, rather than on the public or private nature of the organization (also see Budds and McGraham 2003).

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Endnotes

- 1 Interview with an official associated with Maynilad, 2006.
- 2 Interview with an official associated with Maynilad, 2006.
- 3 Interview with an official associated with Maynilad, 2006.
- 4 Interview with an official associated with Manila Water, 2006.
- 5 Interview with an official associated with Maynilad, 2006.
- 6 Suggestion during an interview from an official associated with Maynilad, 2006.

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