



# Financing access to basic utilities for all

## Meeting report

First regional multi-stakeholder  
consultation

Brasilia, Brazil  
11-13 December, 2006



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Meeting report<sup>1</sup>

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<sup>1</sup> This report is based on the salient features of presentations and discussions that emerged during the meeting. The report was prepared by staff of the Financing for Development Office. The views expressed do not necessarily reflect the position of the United Nations or of any other institution represented at the meeting. Comments and suggestions on the text should be addressed to Daniel Platz (e-mail: [platz@un.org](mailto:platz@un.org)). More details on the meeting, including the list of participants, can be found at: <http://www.un.org/esa/ffd/Multi-StakeholderConsultations/NGOs/indexutilities.htm>.



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## Overview

The consultation was organized by the Friedrich Ebert Foundation in collaboration with the Financing for Development Office of the United Nations Department of Economic and Social Affairs, the UNDP International Poverty Centre and the Ministries of Cities of the Government of Brazil.

It was held in the context of the Follow-up process of the International Conference on Financing for Development held in March 2002 in Monterrey, Mexico. In its resolution 60/188 of 22 December 2005, the General Assembly requested the Financing for Development Office to organize multi-stakeholder consultations in collaboration with experts from the public and private sectors, academia and civil society. These consultations are aimed at better enabling member countries to implement their commitments as agreed in the Monterrey Consensus. The consultation in Brasilia gathered around 30 mostly Latin American experts from central and municipal governments, utility providers, intergovernmental institutions, civil society, private sector, trade unions and academia. The first two days of the discussion (11-12 December) addressed long-term financing mechanisms and cost recovery strategies for extending access to water and electricity to the poor. Participants also focused on economic and social factors to be taken into account in developing long-term financing strategies for basic utilities. On the third day of the meeting (13 December), participants presented their findings and outcomes to high-level government representatives, the broader public and media in an open plenary session.



A major part of the conference centered on important Latin American experiences of utilizing financing options at the international, national, and sub-national level. Participants exchanged their views on the potential of development aid, municipal banks, municipal bonds, pooled financing arrangements, and other local financing mechanisms to mobilize long-term finance. The discussion ventured further into the question of generating sufficient internal revenue and ensuring sustainability of services in the water and electricity sector. Participants addressed implications of the privatization of utilities for the poor, as well as the role of tariff settings and regulations. Among many concrete initiatives to extend utilities to the poor in Latin America, experts highlight



mechanisms for utility providers at all levels. Section (2) will summarize the discussion on ensuring sustainable access to water and sanitation for the poor through internal revenue generation while section (3) will discuss the challenges of internal revenue generation in the electricity sector. Section (4) will highlight macroeconomic factors to be taken into account in the discussion of financing basic utilities for all.

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likely to invest in national or sub-national debt. Participants stressed that national creditworthiness would impose a ceiling on sub-national ratings, .i.e. prospects of cities and states to raise finance on capital markets could never exceed those of the federal government. Many countries in Latin America, such as Honduras had been unsuccessful in attracting investors to their sub-national bonds.

It was highlighted that the first city in Latin America to successfully issue a bond in the international capital markets was the municipality of Rio de Janeiro. The city had issued a bond in July 1996 to re-finance its existing debt, (10.3/8% for US\$125 million over 3-years). The bond was unsecured despite the fact that this was the municipality's first public international debt issue. The Argentinean province of Mendoza had also successfully issued an international bond in August 1996 with a USD 125 million six-year offering to refinance its debt. The bonds were secured by oil royalties paid by oil companies. It was noted, however, that there were several restrictions in Latin American countries regarding debt issuances of sub-national entities.

In Brazil, the main restriction was the Fiscal Responsibility Law (Supplementary Law 101, of May 2000), which was aimed at ensuring macroeconomic stability. It spelled out that public debt as a percentage of current receipts could not exceed a limit established by the Brazilian congress for states and municipalities (2 x total net current income for states and 1.2 x total net current income for municipalities) nor the total personnel expenses (60% of the total net current income). If a municipality did not respect those limits it was not allowed to







market funds, raised through a series of INCA bond issues and long-term loans by international financial institutions. Similar funds existed in low-income countries in Asia, including India and the Philippines. However, some participants mentioned that most of the financial intermediary programmes had not been very successful in financing infrastructure in poor municipalities, highlighting a recent mostly negative report of the Independent Evaluation Group on the World Bank's financial intermediary lending programme.

It was also stressed that one possible advantage of financial intermediaries could be their ability to reduce the time it took for a city to obtain a loan from an international financial institutions, which usually ranged from 1 to 2 years. In this regard, it was underlined that it was important to analyze what factors could facilitate access of municipalities to multilateral, bilateral and national development funds. As an important initiative to facilitate the exchange of experiences, ideas, and knowledge between cities in East Asia in raising funds one speaker referred to the "InfoCity" initiative. The long-term objective of this initiative was to institutionalize the knowledge sharing activities among East Asian cities by anchoring the activities in an organization based in the region. The "Cities Alliance" was also highlighted as another promising effort to help cities develop sustainable capital investment strategies. The Alliance was a global coalition of cities and their development partners, bringing cities together in a direct dialogue with bilateral and multilateral



Current members of the alliance, which was housed at World Bank Headquarters, were cities in Brazil, Canada, Ethiopia, France, Germany, Italy,



entail a significant tradeoff of risk versus borrowing costs. Moreover, bond issuances would have to be very large (in the region of 500 Million USD) to be able to attract international investors.

### ***Legal aspects of sub-national bonded debt - The experience of the Ministries of Cities in Brazil***

In addition to severe structural challenges, such as high poverty rates, social inequalities, and a lack of supporting infrastructure, Brazilian municipalities had faced severe financial challenges when it came to providing access to water and sanitation. These include restrictions on new public debt, exceptionally high financing requirements due to high interest rates and high levels of tax burdens for a prolonged period of time. To provide adequate resources of financing to municipalities, Brazil had established a public fund for compulsory saving called Fundo de Garantia do Tempo de Serviço (FGTS) in 1966,. The fund was based on a contribution equivalent to 8% of the employer's payroll. The FGTS served two purposes. Firstly, it was an unemployment insurance fund for dismissed workers and secondly, it was used to fund Federal urban development projects (water, sanitation and popular housing) at low interest rates.

Yet, as explained above, fiscal measures, including the Fiscal Responsibility Law had restricted lending to the sub-national public sector. However, participants highlighted that recent legislative developments in Brazil could help municipalities in raising finance for utilities. According to the law, the federal government would



acknowledge the difference between current and investment expenditures of municipalities and states and would address the fiscal implications of these two types of expenditures differently. Discussants were optimistic that new parliamentary legislation would make additional funds, including those of the FGTS, accessible to municipalities. Investment needs were huge, in particular in slums or remote urban areas where no adequate conditions for extending connections to utilities existed.

There would still be need for additional funding in addition to federal transfers and above-mentioned funding sources, possibly through market lending. However, it was noted that the experience of Brazilian municipalities with market lending had not been very positive in the past. Private funds seemed to be more effective for large scale investments that did not have an immediate impact for the poor such as the construction of new water treatment stations.

While the federal government of Brazil established guidelines and provided part of the financing for basic utilities, the actual responsibility for service delivery was with the states and municipalities. The new law did spell out a framework of for public-public partnerships between states, municipalities and the federal government. Such a legal framework was also important in order to establish guidelines for how to deal with state-owned companies, which were responsible for the bulk of service delivery in Brazil and many of which were bankrupt in the country's poorer states. Moreover, the new legislation would also increase social participation in extending water and sanitation to the poor. In 2007 the Ministry of Cities planned to develop a national sanitation plan. The new legal environment



would facilitate the funding of this plan as it would allow municipalities to move away from a current stop-and-go policy towards a medium and ultimately long-term national strategy. This could provide financing space for municipalities in a fiscally responsible manner.

## **2. Ensuring sustainable access for the poor through internal revenue generation – electricity**

### ***Pre-conditions for Successful Sustainable Investment into utilities***



investment climate, the territory, the regulatory climate and the fiscal and legal framework, including anti-corruption laws. Technology selection and calibration should be measured against their effectiveness for the locally expressed needs and have a small footprint, i.e. they should be green, clean, and lean and fit with of the



Economic sustainability could also be promoted through the mobilisation of local private sector capital where it had the potential to free public funds.

With regard to the technology employed participants highlighted the importance of the transfer of appropriate knowledge and the need to focus on climate-proof projects. Moreover, local technologies should be updated and innovation promoted as long as it was appropriate to local circumstances and needs. In addition, discussants thought it was essential to stimulate local research and development policies in cooperation with the population and NGOs.



lived in urban areas in 1950, this share had climbed to 47% in 2000 and was expected to rise further to 60% in 2030.

Nowadays 40% of the poor of the world lived in slums. It was noted that electricity in urban areas was on average 7 times cheaper than in rural areas due to the larger proximity between dwellings and the electricity net. For instance, the less industrialized Northeast area of Brazil, which represented about 30% of the population of the country had the lowest per capita domestic consumption of energy (262 kWh/capita in 1999). The Southeast area with about 42% of the population was an area of larger industrial development with the highest regional per capita consumption in Brazil (678 kWh/capita in 1999). However, closer proximity to electricity nets could also lead to a bigger number of illegal connections, interferences with meters or non-payment of tariffs.

It was further highlighted that there seemed to be a positive correlation between the degree of human development as measured by the Human Development Index (HDI) and access to energy.

Decentralizing the generation of energy and employing local resources more effectively were seen as viable strategies to confront this issue and bring more access to electricity to the poor. Huge potential would lie in the promotion of off-grid access to electric power services to the poorest layers of the population through renewable energies.

Some of these efforts had been spearheaded by international groups, including the Global Network on Energy for Sustainable Development (GNESD), a





UNEP facilitated knowledge network of developing world centers of excellence and network partners. Barriers to renewable energies that had to be overcome were to a small extent technical barriers and to a bigger degree political and institutional. Financial and economic barriers existed as well due to the relatively high initial fixed costs of small scale systems. To overcome these barriers it was essential to build markets of a minimum size.

### ***The “LUZ PARA TODOS” initiative***

Participants also discussed President Lula’s “LUZ PARA TODOS (LIGHT FOR ALL)” initiative, a joint effort of the Ministry of Mines and Energy, Centrais Elétricas Brasileiras ELETROBRAS (Brazilian Electrical Sector Holding Company), state and private distribution utilities (63 in total), state and municipal governments, and other partners, including civil society.

The main objective of this initiative was to extend electricity to the whole population in Brazil by the year 2008. To reach this goal, there was a need for 2.5 million new connections. The estimated cost would be 6 billion, more than 70 % of







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profits? Moreover, what could be justifi



payment mechanisms and better tailored subsidies. Moreover, local development factors needed to be taken into account to evaluate the long term sustainability of any project.

### **3. Ensuring sustainable access for the poor through internal revenue generation – water and sanitation**

#### ***Raising internal revenue generation through participatory approaches - The experience of Porto Alegre***

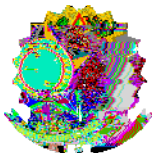
Discussants focused on the experience of expanding utilities of the water and sanitation company, DMAE, of the city of Porto Alegre, Brazil. DMAE presented a success story of the public sector in developing countries. DMAE was fully owned by the municipality of Porto Alegre but had operational and financial independence. The



was its participatory character where public stakeholders could exert control over quality and reach of the service



operating costs. No governm



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in the invoice was applied by the utility provider. As of September 2006 the social rate had reached approximately 116.000 users (4,5 % of total users). Its funds had reached 6,1 million pesos annually (0,9% of the total turnover). The average discount for a beneficiary was 40% and the average invoice for water and sewage after the introduction of the discount stood at \$6 for month. Elaborate proceedings had been put in place to deal with bad debt of users. Concessions were made in the amount of 9.5 Million Dollars, which reduced the percentage of users with debt from 70% to 20% within the first twelve months.

The social rate and extended benefits, such as the cancellation of debt incurred before 1999, had also been offered to institutions that serve public interests, such as universities and hospitals.

### ***Increasing internal revenue generation through minimizing losses - The experience of Mexico City***

During this session participants appraised the experience of Mexico City with providing water and sanitation to its citizens. The 9 million inhabitants of Mexico City correspond to 1,895,750 households, which were billed approximately 380 million dollars for water usage in 2006. Mexico City suffered from inequitable distribution of water. Consumption of water was 20 times higher per capita in rich neighborhoods



Government of about 60% of total distribution costs. Enhanced efforts had been put in place to increase access to water for Mexicans in the last decade. From 2001 to 2006, 107 wells had been improved and repaired while 58 wells had been replaced, altogether accounting for about 3.6% of the total water consumption of the City.

Leakages, however, continued to be a major problem. Currently, about 35% of water was lost. The fact that one third of Mexico City's water would come from sources that were located further than 160 km outside of the city would aggravate the problem. On average, distribution networks were 50 years old. Moreover, tectonic movements below the ground of the city would further damage and dislocate the water pipe system. Annually, about 30,000 not visible and visible leaks had to be repaired in the water distribution system. To tackle this problem, old pipes had been substituted by High Density Polyethylene (HDPE) pipes, which exhibited higher resistance against environmental stress cracking. From 2001 to 2006 more than 822 km of secondary networks (6.7% of the total) were substituted and about 156 km reinforced.

Another geographical phenomenon that had complicated matters was the fact that the foundation of the city kept on sinking further into the ground. In this regard, it was also stressed that an improved drainage systems and better water pumps had played a critical role in preventing flooding and increasing sustainable use of water in Mexico City. Further efficiency-enhancing measures included the creation of 336 sub-sectors of the water network, which had enabled authorities to control volumes more precisely and to reduce the potential loss from leakages. Water management



was further improved through the establishment of 117 new hydrometric stations over last five years, which were projected to help avoid the leakage of up to 3,000 l/s during the next three years. As regards improvements of the quality of water, it was mentioned that a central laboratory of the city coordinated the collection of up to 50,000 random samples per year checking for 70 different bacteriological, chemical, and physical irregularities.

In a collaborative effort, the Federal Government, the Government of the Federal District and of the Government of the State of Mexico coordinated improvements through “Fideicomiso 1928”. The goal of this endeavor was to





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potentially adverse effects of the mostly volatile aid and volatile private capital flows. Concerning the role of capital inflows in financing basic utilities discussants noted that private investment in basic utilities had often been unreliable. In addition, its focus on profits often conflicted with the moral prerogative of ensuring access to all. The long-term challenge would lie in achieving long-term capital accumulation and growth as well as equity in access to basic utilities.

### ***Macroeconomic risks, aid and debt relief***

Three key issues highlighted in the course of this part of the discussion were risks related to maturity mismatches, interest rate risk and exchange rate risk. It was noted that borrowing from financial markets on a short term basis was inappropriate for long term infrastructure investments and could lead to maturity mismatches and financial fragility. This would be worsened by the fact that costs could only be recovered very slowly in the water and electricity sector although loans had to be paid back much earlier, usually within a two-three year period. As a result, many poor governments had to reborrow, in order to finance their borrowing. Another source of financial fragility would be interest rate risk. As the financial sectors in the developing world had become much more deregulated over the last decade, interest rates were moving more freely. Due to external factors or increased demand for funds itself interest rates at the time of borrowing could differ from the time of refinancing adding a factor of uncertainty and risk to the loans taken out for investments.









In addition, legislation in many Latin-American countries would rule out bail-outs of sub-national government by the federal government. A case study for Bolivia was quoted, which described an 11% cut of federal transfers to states and cities after Bolivia's GDP had dropped in 2001. As a result of the Bolivian fiscal law, municipalities that went bankrupt were not bailed out. This led to the disconnection of services for many parts of the population. On a related note, it was observed that methods to target municipalities directly had been developed through a joint World Bank/IFC Municipal Fund. Several participants saw these loans as risky as they would not be secured by the government. It was also noted that lending directly to sub-sovereign entities in developing countries could also be against the World Bank articles of agreement

Several participants emphasized that the financing potential of PPPs was often exaggerated. Public-private partnerships had to be carefully designed and balanced. For example, some preference was expressed for a model in which the private sector entity would be responsible for the construction and extension of the service, while delivery would be handled by the public sector. The issue of who retained the profit was also seen as contentious. In the eyes of many participants, profits should be reinvested in utilities in developing countries and not be distributed to shareholders in developed countries.

Participants recalled cases, in which the public sector had to bail out private sector entities facing bankruptcy in PPPs. This phenomenon would impose additional risk on the government, which was labeled "bankruptcy risk". It was



highlighted that PPPs usually implied loan guarantees for the investor. However, these loan guarantees would often be off-budget, i.e., it was treated as a contingent liability that did not show on the main balance sheet of the municipality or government. The IMF for example, had warned about the vulnerabilities of municipalities with off-balance sheet items related to PPPs.

Discussants also deplored the absence of regulation and competition in the water and electricity sectors. For example, in Chile, a lack of transparency in the water sector had raised several issues with a water provider consortium in Santiago. Because the legal boundaries of the consortium were unclear to the government and regulatory bodies, they did not keep the constnromse jw -er consortiilities233iago.0 48h