Money talks
How aid conditions continue to drive utility privatisation in poor countries

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Contents

1 Introduction

2 Conditionality in the face of 'ownership'

2.1 How conditionality fails developing countries

2.2 The donor rationale for conditionality

2.3 Commitments to increase national 'ownership'

2.4 The limits of 'ownership'

2.5 Continuing conditionality: evidence from programme documents

2.6 Conditionality in practice – findings from Ghana, Uganda and India

2.7 Cross-conditionality – magnifying the mistakes

2.8 Soft conditionality – selectivity, policy advice and technical assistance

3 Water and energy privatisation – economic policy conditions hit the ground

3.1 The evidence that water and energy privatisation are failing the poor

3.2 Why does privatisation often fail the poor?

3.3 Positive alternatives to privatisation

4 ActionAid's conclusions and recommendations

References

1. Introduction

Two decades after the introduction of the International Monetary Fund (IMF) and World Bank structural adjustment programmes across Africa, Asia and Latin America, donor agencies are continuing to use their financial and technical muscle to pressure the world's poorest countries into adopting risky and unproven economic reforms. New research by ActionAid shows that aid money, new loans and debt relief are still contingent on governments accepting highly specific economic reforms that are conceived, designed and approved in Washington, by the IMF and World Bank staff and their boards, not in the countries where they are implemented. If countries fail to comply with these stipulations, both multilateral and bilateral donors will withhold funds.

The conditions that donors attach to their aid programmes go far beyond any legitimate measures to ensure that aid money is used efficiently for its stated purposes. Indeed, they go to the heart of the public policy-making process in the countries concerned. Utility privatisation is a prime example of this trend, and is particularly worrying given its relevance to poverty reduction. In a large number of low-income countries, donors are pressuring governments to sell off and sub-contract services in water and electricity to private companies. They do so despite the lack of evidence that this increases access for poor people, accountability to consumers or cost-effectiveness.

In this report ActionAid questions whether donors should be pushing their policy preferences so strongly in poor countries. The evidence suggests that donor conditionality distorts and undermines domestic political processes, and that the reforms have a poor track record of meeting the needs of poor communities.

Case studies collected by ActionAid programmes and partners in Ghana, India and Uganda demonstrate how aid is still tied to private sector involvement in utilities. For example, in Ghana, the World Bank made private sector participation a condition of additional funding for modernisation of the water system. In the Indian states of Orissa and Andhra Pradesh, World Bank loan conditions have pushed the privatisation of electricity. In Uganda, donors are pressing for the abolition of the public sector water company, and the establishment of a lease contract to a private multinational.

The solution is for donors to undertake far-reaching reforms in how aid is planned and delivered. Recent efforts to increase the 'policy space' for poor countries are important and should be welcomed. But they do not go far enough. ActionAid's research suggests that economic conditions, such as utility privatisation, are still explicitly included in key documents outlining the conditions attached to aid. Problems with World Bank and IMF policy conditions are further magnified because bilateral donors are increasingly aligning their own conditions with those of the multilateral donors.

Donor agencies have a role to play in an open dialogue with poor countries about policy alternatives. But they are overstepping the mark. In the case studies examined by ActionAid, donor conditions have given governments little leeway to explore policy options. Nor are the conditions always explicit. Donors also use technical assistance to define policy goals for recipient governments. In the Indian electricity cases ActionAid has found that the UK Department for International Development has sub-contracted international consultancy firms to 'advise' the governments on the implementation details.

ActionAid believes that it is time for poor countries to be put in the 'driving seat' of reform, as the genuine arbiters of policy change. To make this happen, the major shareholders on the boards of the International Financial Institutions (IFIs) must grasp the nettle of aid reform. There should be an end to the tying of IFI loans and bilateral aid to the privatisation of utilities and other economic policies. In addition, technical assistance should not be used to steer decision-makers in the direction of predetermined policy choices. Finally, a fully independent review of the use of economic policy conditionality by IFIs and bilateral donors is overdue. It should focus on the impact on poverty reduction and democratic ownership of policy reforms, and include an assessment of technical assistance.

Liba Taylor/ActionAid UK

2. Conditionality in the face of 'ownership'

2.1 How conditionality fails developing countries

Policy 'conditions' (see box 1) attached to aid money are failing developing countries for two key reasons. Firstly, the use of conditions by donors often undermines democratic accountability within countries. Ironically, this runs directly counter to the spirit of donor-backed initiatives to promote good governance and enhance government accountability to citizens. In this context, conditionality is:

- **unfair:** conditionality perpetuates a relationship between donors and developing countries that is already stacked in favour of the former. Many of the poorest countries depend on external finance for over half of their national budgets, which gives donors strong leverage over policy choices. Threatening to withhold essential loans and debt relief unless the recipient country agrees to reforms such as the privatisation of public utilities is an unfair abuse of this power – not least because many of the benefits of such privatisations often accrue to private sector companies from the donor countries themselves, raising concerns about conflicts of interest.

- **undemocratic:** the World Bank and IMF consider the participation of non-governmental actors in national policy debates to be useful mainly insofar as it "enhances the likelihood of successful implementation" of IFI programmes (IMF 2002, also IMF 2001a, World Bank 2001). There is no clear indication that the World Bank and IMF consider democratic accountability to be of any importance in its own right – in fact, many IMF staff argue that conditionality is useful in enabling allies within governments to push through unpopular reforms (Boughton 2003)[1]. Yet the formulation of key policies by IFI staff, working in a closed process with small groups of senior government officials, raises serious concerns. First, it gives significant policy influence to organisations that are outside the domestic political sphere and are not answerable to the electorate. Second, conditionality tends to skew government accountability away from the electorate and towards the donors, and publicly signals a lack of ownership on the part of the country (Wood 2004). This has often undermined popular confidence in the policy-making process in developing countries, and in some cases has led to mass demonstrations against what are perceived to be externally imposed reforms (Ellis-Jones 2003).

Secondly, as a direct result of this failure to engage in democratic debate over the most appropriate policy choices for each country, the policies themselves have largely failed to deliver. In this context, conditionality has been shown to be:

- **ineffective:** despite the escalating use of economic policy conditions during the 1990s, they have often failed to introduce long-term sustainable policy change: both the World Bank and IMF have complained of their lack of success in achieving implementation of their programmes through their use of conditionality (e.g. Killick 2004). One recent internal study found that 44% of all IMF-supported programmes approved between 1992 and 1998 suffered "major and irreversible interruptions" (Ivanova et al. 2003). Often developing country governments have agreed to policy reforms as a condition of new lending, only to abandon the reforms when the impact of the policy change was shown to be unacceptable. In other cases, reforms fail where the heavy use of conditionality reflects externally imposed solutions that fail to meet local needs. In both cases, conditionality has led to policy swings in developing countries, causing further vulnerability for people living in poverty.

- **inappropriate:** most importantly, when measured against the aim of providing poor people with sustainable access to the services they need, privatisation has all too often been shown to miss the target. It is not surprising, perhaps, that conditionality which has been predetermined by IFIs and bilateral donors tends to reflect the priorities of external financiers at the expense of the needs of poor people. An approach that makes heavy use of policy conditions tends to exclude from the decision-making process precisely those people who are able to provide the most accurate and context-specific input: the users themselves. As the next chapter of this report shows, the consequence of this non-participatory approach to policy-making is that conditionality has failed the poor.

[1] *The same views were expressed in interviews with senior staff in the IMF's Fiscal Affairs Department and Policy Development and Review during meetings on February 2nd-3rd 2004.*

Box 1 What is conditionality?

Conditions – stipulations that countries must comply with in order to obtain donor funding – take a number of different forms. Yet the underlying principle remains the same: donors are using financial pressure to leverage actions they believe would not otherwise be taken. Conditions are spelled out in a range of documents, including Poverty Reduction Strategy Papers (PRSPs) which countries must produce every three years in order to qualify both for concessional lending from the World Bank and IMF and for debt relief under the Heavily Indebted Poor Countries (HIPC) initiative. They are also included in the Letters of Intent and Letters of Development Policy which present a country's economic reform intentions to the IMF and World Bank respectively.

Conditions form a key element in the individual lending strategies produced by the World Bank and IMF. Both the World Bank's Poverty Reduction Support Credit (PRSC) and the IMF's Poverty Reduction and Growth Facility (PRGF) are supposed to be based on policies identified in a country's PRSP, yet they often include conditions that have not been agreed through the PRSP process. Conditions are also found in the World Bank Country Assistance Strategy (CAS) – 'a master plan' for each of the countries in which it works.

Broadly speaking the IMF is supposed to restrict itself to quantitative conditions that relate to a country's macroeconomic and fiscal situation (for example, inflation targets, and budget deficit targets that countries must observe in order to get aid money). The World Bank has a broader remit, covering structural conditions that relate to more detailed institutional reforms, often in the public sector, such as privatisation, trade liberalisation and civil service reform. The Bank also uses more specific conditions contained in individual Project Appraisal Documents (PADs). In practice, as this report indicates, there is considerable overlap between the two institutions – especially in policies relating to privatisation, which regularly feature in both IMF and World Bank conditionality.

Within these different lending instruments and documents, conditions fall under three main categories:

1. Prior actions – that must be taken by the government before any IFI lending, to demonstrate commitment to a reform programme. These are the strongest conditions, used most heavily where donors doubt the reform credentials of the government.

2. Performance criteria, or 'trigger' conditions – these are periodic conditions that must be met over the course of a programme in order to release a further tranche of money. A country's credit limit with the World Bank is varied according to how well they meet the performance criteria – there are high, medium and low case lending scenarios, dependent on how well a country meets performance criteria.

3. Structural benchmarks – that are monitored to ensure that a programme is 'on-track', but don't necessarily directly affect the release of resources.

Source: UNCTAD 2002

2. Conditionality in the face of 'ownership'

2.2 The donor rationale for conditionality

Given these widely documented failings, there has long been criticism of the use of policy conditionality by donors (e.g. Buira 2003, Kanbur 2000). The World Bank and IMF, which together operate as the linchpin of the international aid system, have attracted the most sustained criticism – particularly for the escalation of loan conditions in connection with the structural adjustment programmes of the 1980s and 1990s (see box 2). The IMF has confirmed that by the end of the 1990s almost all of its programmes included some element of structural conditionality, and that the average number of conditions in each programme had increased by more than half since the 1980s (IMF 2001a). The World Bank acknowledges that its use of binding 'tranche release' conditions more than doubled over the period, to an average of 25 per programme (World Bank 2001).

The rationale for the use of conditionality has been spelled out clearly by the World Bank in its retrospective assessment of structural adjustment lending, where it portrays conditionality in the context of a mutual understanding between external financier and borrowing government:

> "On the basis of this understanding with the government on an overall programme, a set of policy measures is developed, which the Bank has traditionally attached as conditionality to tranche releases of specific loans. Conditionality thus links financial support to the implementation of a programme of reforms considered critical for the country's economic and social adjustment." (World Bank 2001)

Both the World Bank and the IMF remain fully committed to the continued use of conditionality as a central element of their policy-based lending (World Bank 2002a, IMF 2002). Yet they increasingly argue that the conditions themselves are to be owned by the recipient country, not imposed from the outside, to be used as a way of backing reformers in domestic policy disputes, and as a tool for 'locking in' country-specific policy choices (Koeberle 2003). This chapter explores whether this new approach to conditionality marks a genuine change, or whether developing country governments are in fact still being pressured to adopt policies that donors believe would not otherwise be implemented.

Box 2 Adjustment and conditionality

The increased use of aid conditions during the 1980s and 1990s coincided with a major shift in the IFIs towards 'structural adjustment' programmes in the poorest countries, which aimed to achieve fundamental economic reforms deemed necessary to make effective use of aid, attract private investment and foster growth. These systemic reforms represented a sea change in what aid was about: under structural adjustment, the policy conditions in effect became the projects, with the donors investing in 'economic infrastructure' where they previously invested in physical infrastructure (Hopkins 1997). The nature of conditionality, as well as the number of conditions, has also changed as its use has escalated. Initially, structural adjustment dealt with 'first generation' reforms aimed at removing what the IFIs saw as economic distortions. Many of these reforms, such as changes to the exchange rate regime, were relatively simple, 'stroke of the pen' interventions. Subsequently, the IFIs have moved onto a more ambitious set of 'second generation reforms'. These 'deep' reforms involve such changes as reducing the size of the civil service, abolishing state marketing boards, decentralising public services and privatising utilities. Nearly one quarter of all World Bank conditions now relate to these kinds of far-reaching institutional changes (World Bank 2001).

2.3 Commitments to increase national 'ownership'

In recent years the IFIs have introduced major changes to their adjustment lending programmes, partly in response to charges that they have failed to foster country ownership and sustainable policy reform. In particular, since 1999 low-income countries have been required to write Poverty Reduction Strategy Papers (PRSPs), which set out broad economic and social development priorities, in order to obtain debt relief and adjustment lending. The PRSP is supported by Poverty Reduction Support Credits (PRSC) which are designed to translate the PRSP's headline goals into structural reforms on the ground. The PRSC is expected to build on completed actions by recipient countries ('ex-post conditionality'), rather than lend on the basis of future promises ('ex-ante conditionality') used in traditional adjustment programmes (Wood 2004). Meanwhile the IMF's adjustment tool, the Poverty Reduction and Growth Facility (PRGF) is designed to mesh closely with the PRSC, and use a complementary set of conditions.

Following on from the introduction of PRSPs, the World Bank and IMF each embarked on reviews of their past use of conditionality, with a view to establishing guidelines for future use. The IMF published new guidelines in September 2002, committing itself to 'streamlining' its use of structural conditionality, and focusing instead on its core areas of responsibility: macroeconomic stability, monetary and fiscal policies and financial systems (IMF 2002). This commitment was partly a response to criticism that the IMF has strayed outside its remit by expanding its conditionality into structural areas such as utility privatisation, and so blurred the division of labour between itself and the World Bank.

For its part, the World Bank is soon to unveil its own updated lending policy directive, including new guidance on conditionality, participation and other elements of process and design. The Bank published a discussion paper in June 2002 outlining some of its proposals for the updated policy directive and opening the debate to public consultation. It supported the IMF's preference for a more streamlined use of conditionality, noting that the World Bank itself now operates on "a presumption of greater focus and selectivity" – although it suggested that there should still be flexibility to apply more conditions as and where needed (World Bank 2002a).

Tony Durham/ActionAid UK

2. Conditionality in the face of 'ownership'

Box 3 IMF 'streamlining' – where have the structural conditions gone?

Since the IMF committed itself to streamlining in late 2001, there has been a marked decline in the number of structural conditions in its programmes. Nonetheless, some economic policy conditions in areas such as utility privatisation persist. For example, out of 18 Poverty Reduction and Growth Facilities (PRGFs) surveyed in late 2003, two involve explicit privatisation conditions in the electricity sector, and nine refer to the importance of electricity privatisation – suggesting that the Fund is continuing to promote privatisation 'off the record'. Two of the PRGFs made reference to water privatisation (Eurodad 2003a). Moreover, it is unclear whether streamlining has really achieved any reduction in the aggregate policy conditionality facing poor countries. Indeed, there is evidence that many of the structural conditions previously used by the IMF are being off-loaded onto World Bank PRSCs – for example, in Zambia, Nicaragua and Tanzania, the World Bank has taken on privatisation conditions previously found in IMF programmes (Eurodad 2003b).

In both these key policy documents, the World Bank and IMF lay great emphasis on the importance of national ownership of the policy conditions needed to unlock loans or debt relief to the recipient country. They acknowledge that a lack of ownership was partly responsible for the poor performance of many of their previous programmes. Now, by contrast, the IFIs are keen to talk-up the concept of partnership between donors and recipients – a 'global partnership against poverty', in the words of World Bank President James Wolfensohn at the UN's Financing for Development conference in Monterrey, Mexico, in March 2002:

> "This is not about rich countries telling developing countries what to do. This is about creating a chance for developing countries to put in place policies that will enable their economies to grow. Policies that are home grown and home owned. For the surest foundation for long-term change is not development by fiat, but social consensus."

Most significantly, in support of this switch to policies that are 'home grown and home owned', the World Bank states that its new lending directive will no longer specify the policy conditions which countries must meet in order to qualify for loans, including the pressure for privatisation which it admits has been a key feature of Bank lending in the past (World Bank 2002a). Once again, national ownership is preferred to policy prescriptions imposed from the outside:

> "This shift in focus reflects the recognition that there is no single blueprint for reform that will work in all countries, and that any country's reform programme must be designed with country ownership to fit that country's specific circumstances."

Much of this new enthusiasm for national ownership has been stimulated by conditionality's lack of success in the past. Both the World Bank and IMF have complained that their increased use of conditionality has not brought the desired results in terms of policy change, and many of their own studies suggest that a lack of government commitment has been a key element in this failure (IMF 2001b). It is in order to deal with this lack of government commitment that the World Bank and IMF have resolved to promote the concept of national ownership through PRSPs, just as 'streamlining' conditionality is a calculation that fewer, more focused conditions will be more effective than a scattergun approach.

When taken together, the re-framing of adjustment programmes as tools for poverty reduction in the form of PRSPs, and the streamlining of IMF conditionality, represent an ambitious attempt to change how the donors do business in poor countries. Many donor governments have cited these changes as evidence that criticisms of conditionality are outdated and inaccurate. Yet the evidence in this report suggests that change in practice has lagged far behind the change in language (see box 2). More importantly still, none of the reforms of the past five years fundamentally alter the role of the IFIs as arbiters of appropriate policy in poor countries, question the use of aid to drive policy reform in the donors' preferred direction, or challenge the content of those reforms.

2.4 The limits of 'ownership'

The limitations of the new approach to conditionality are illustrated by the donors' understanding of ownership. Both the World Bank and IMF state that national ownership is seen first and foremost as a means to the successful implementation of programmes, not as an end in its own right. For this reason, they emphasise the commitment which must be shown by governments in following those programmes closely, as in the official IMF definition that national ownership is "a willing assumption of responsibility for an agreed programme of policies, by officials in a borrowing country who have the responsibility to formulate and carry out those policies" (IMF 2001b). Similarly, the World Bank has defined ownership as "a concept that denotes a high probability that the policy and institutional changes associated with a lending operation will be adopted and implemented even if there is internal opposition" (World Bank 2001).

Thus for the IFIs, ownership is wholly compatible with staff writing or heavily influencing a reform programme, and it being pushed through in the face of popular opposition. Working documents from within the IMF have confirmed that government commitment to implementing the programme is more important than national involvement in formulating the policies in the first place:

> "Ownership does not require that an IMF-supported programme be a government's first choice, nor that it be the programme that officials would have preferred in the absence of IMF involvement… As a general proposition, what is essential is that the responsible and controlling officials be committed and that opposition can be overcome." (Boughton 2003)

The IMF therefore argues that there is no necessary conflict between national ownership and conditionality, once 'ownership' is taken to mean the government's acceptance of the conditions of a programme and its agreement to follow that programme through. That the conditions may still come from the IFIs is of no importance in this equation. To adapt Wolfensohn's statement cited earlier, it is far more important that the policies be home 'owned' than home grown.

This approach to ownership helps to explain why consultation in PRSPs, and around contentious reforms such as utility privatisation, is often criticised for largely being an explanatory exercise designed to win over a sufficient number of reform-sceptics – rather than part of a shared process of evolving a reform model. As a result, important insights have been lost, and reforms have often foundered – both because they have ignored local social, economic and political realities, and because they have failed to secure popular legitimacy (eg Oxfam 2004, WaterAid 2003, Dubash 2002).

2.5 Continuing conditionality: evidence from programme documents

Given this attenuated definition of national 'ownership', it is perhaps to be expected that loan conditionality is dominated by familiar themes from the past. A recent ActionAid analysis of World Bank and IMF lending in the period following the introduction of the PRSP reveals that the privatisation of utilities has remained a prominent condition – both of individual project loans and of major new financing mechanisms such as the World Bank's PRSC and the IMF's PRGF (Joyner 2004).

The countries where donors continue to tie aid to utility privatisation include:

- **Burkina Faso,** where swift implementation of the private sector development strategy and completion of the utilities reform programme are included as triggers for high-case lending in the World Bank's Country Assistance Strategy for 2000-03. Outsourcing urban water services to the private sector was included in the Enhanced Structural Adjustment Programme agreed with the World Bank and IMF for 2000-02, while contracting out commercial operations and financial management to the private sector was included as a project development objective of the World Bank's Ouagadougou Water Supply Project 2001.
- **Ghana,** where substantial progress in privatisation of the energy and water sectors was included as a trigger for high-case lending in the World Bank's Country Assistance Strategy for 2000-03 (this was worth more than double the 'low-case' lending scenario of $285m if privatisation progress was judged unsatisfactory). The introduction of public-

2. Conditionality in the face of 'ownership'

private partnership in the energy sector was included as a trigger for the World Bank's PRSC in 2003 (privatisation of the Electricity Company of Ghana was also included in the final year of the IMF's PRGF 2000-03). Meanwhile, the World Bank's proposed Water Restructuring Project 2004 stipulates either a management or lease contract for private sector operation of urban water systems.

- **India,** whose Country Assistance Strategy for 2002-04 identified a 'proper environment for private investment and management' in utilities, plus privatisation of urban services (especially water) as performance indicators. The Country Assistance Strategy also recommends support from the World Bank's International Finance Corporation (IFC) for those states in which reforms are establishing an 'enabling environment' for the private sector. Whereas compliance with these goals will trigger $3bn of lending a year, failure to meet these goals will reduce lending to approximately half this level.

- **Kenya,** where private sector leadership in the tendering process for restructuring the Kenya Power and Lighting Company was made a condition under the World Bank's Emergency Power Supply Project 2000. The presentation of a parliamentary bill to establish a framework for the privatisation and sale of public assets was also included as a structural benchmark for the first year of the IMF's PRGF 2003-06.

- **Pakistan,** where privatisation of infrastructure services was made a performance indicator in the World Bank's Country Assistance Strategy 2002. The establishment of a privatisation commission and creation of a master list of privatisations (including water distribution and waste water plants), plus completion of privatisation in various sectors (including waste water) were included as prior actions for the World Bank's Structural Adjustment Credit for Sindh Province in 2002.

- **Peru,** where the World Bank's Country Assistance Strategy 2002 recommends the use of IFC loans and other forms of financing to provide support for infrastructure privatisation. Institutional reform and the contracting out of operations to the water sector are included in the World Bank's National Rural Water Supply and Sanitation Project 2002. The privatisation of three electricity companies was included as a structural benchmark for 2002 in Peru's Standby Arrangement with the IMF, but mass protests at the proposed sales in and around the town of Arequipa halted the privatisations and led to a revision of the programme.

- **Tanzania,** where the private operation of water and sanitation services was made a performance indicator in the World Bank's Dar es Salaam Water Supply and Sanitation Project 2003. The preparation of an integrated private sector development strategy was included as a prior action in the World Bank's PRSC 2003. Privatisation of energy was included in the IMF's PRGF 2003-06, just as privatisation of the Dar es Salaam Water and Sewerage Authority was included in the PRGF 2000-03.

- **Uganda,** where the privatisation of water and energy sectors was a key objective of the World Bank's Privatisation and Utility Sector Reform Project 2000, followed by a further loan to the energy sector in the Fourth Power Project 2001. Preparation and implementation of a private sector support policy was included as a trigger for the PRSC 2002, with detailed steps towards water and sanitation services privatisation included in PRSC 2003, under a prior action requiring 'satisfactory implementation' of sector reforms.

These examples illustrate the remarkable consistency with which the donors are promoting utility privatisation through aid conditions. In another recent survey of 14 low-income countries where the World Bank is funding the water sector, 12 of the countries faced some form of privatisation condition (Wood 2003). If the range of alternative reforms being supported with donor funding is one important test of genuine local ownership, and of donors' willingness to enter into open policy dialogue, then the IFIs do not score highly. Despite stated donor commitments to jettison privatisation blueprints in favour of a case-by-case approach to reform, old habits seem to die hard.

In fact, despite the language of ownership, the IFIs have openly declared their intention to promote privatisation through PRSPs. The most detailed statement of this came with the publication of the World Bank's Private Sector Development (PSD)

Strategy in April 2002. The strategy, approved by the board, commits the World Bank Group to promoting the privatisation of infrastructure and social services in developing countries, with a particular emphasis on 'frontier' sectors such as water, energy, healthcare and education. The PSD strategy identifies the PRSP process as a key vehicle for achieving that aim. World Bank staff are expected to encourage private sector interventions through PRSPs, and then to base their individual Country Assistance Strategies on the proposals identified (World Bank 2002c). With such explicit statements of intent, it is unsurprising that privatisation continues to crowd out other alternatives in the IFI's lending programmes.

Bilateral donors have themselves cited the absence of economic policy alternatives in areas such as privatisation as a key failing of the PRSP process (e.g. DFID 2002b). This concern was recorded in the early review of PRSPs launched by the World Bank and IMF in 2001, in which they conceded that there had been little discussion of alternative policy choices and that the new process had had no impact on the macroeconomic frameworks of the countries concerned (IMF & IDA 2002). Yet the second review met the same criticism: that the central macroeconomic and structural policies underpinning the PRSPs still remain non-negotiable (IMF & IDA 2003). This absence of public debate about alternatives and the consistent resort to conditionality is especially problematic when the policies concerned are so controversial, and also so risky and unproven, as the ActionAid case studies in the next section demonstrate.

2.6 Conditionality in practice – findings from Ghana, Uganda and India

ActionAid's new research in Uganda, Ghana and India shows the extent of pressure being exerted to this day on developing country governments to accept and 'own' IFI policy prescriptions. Interviews with officials in recipient countries reveal that they are left in no doubt as to the policy choices expected of them if they wish to gain access to essential loans and debt relief. In many cases the countries concerned are so dependent on this finance that they have no choice but to accept the conditions attached.

Uganda

In Uganda, the pressure on government officials to agree to the privatisation of public enterprises originated in the country's structural adjustment programme, which identified financial reform and privatisation as two key priorities. Yet the pressure to privatise the urban water sector has continued and been strengthened since the PRSP has been introduced. For example, in 1999 the Local Government Development Programme in Uganda was identifying increased private sector delivery of basic public services as a performance indicator. By the 2002 PRSC, increased private sector involvement in the water sector had become a trigger condition. These reforms have been pursued without the stakeholder input which is supposed to be a central element in the PRSP. According to the Ugandan NGO, AWEPON, which has followed the process closely:

> "The debate about water privatisation never took place. The policy is being implemented and there is nothing that can be done to change it. Basically the donors are now saying to us, 'We have come this far, now you have to come to help us and make it work. You have no choice.'"[2]

The complaint is echoed in parliament. As one Ugandan MP put it: "The donors are telling the government what to do – it is not fair the way they influence government policy."[3] Yet the most compelling evidence of the pressure faced by state officials comes from within Uganda's National Water and Sewerage Corporation (NWSC), the body responsible for water supply in the country's main urban areas. The NWSC already involves the private sector in 70% of its activities and is resisting the move to a private sector lease contract that donors are demanding under a prior action in the current PRSC. Significantly, the fact that major productivity gains have already been achieved in Uganda's urban water sector – while retaining substantial public control – has led the donors to shift their arguments for introducing a lease contract. Whereas they had previously cited inefficiency as the rationale for moves towards privatisation, it is now

[2] *Interview, December 11th 2003*

[3] *Interview, December 11th 2003*

2. Conditionality in the face of 'ownership'

being justified as a way of 'locking-in' the reforms and enable debts to be restructured. So far, only a lack of significant investor interest has held back the closure of the public parastatal and the move to a lease contract, under which a private sub-contractor pays the government a set fee in exchange for retaining operating profits.

Officials in the NWSC complain that the unequal power relationship between host country and donor community plays a large part in determining the final policies to be adopted. As one senior manager noted: "There is a lot of arm twisting going on here – the donors will argue that the private sector should be brought in under all circumstances."[4] This evidence of continuing pressure on the government and an absence of wider policy debate reflect earlier findings that the World Bank and IMF effectively sidestepped the PRSP process in Uganda. That process was commended for having opened up genuine dialogue between the government and civil society organisations, yet the conditionality included in subsequent loans to the country failed to reflect the conclusions of the debate. Instead, interviews with the officials concerned indicated that "the actual policies in the loans were determined by the IMF and World Bank representatives in consultation with small technical teams within the Ministry of Finance and the Central Bank" (Nyamugasira and Rowden 2002).

Ghana

Ghana tells a similar story, where the World Bank has also been promoting privatisation of the country's urban water systems since the 1990s. In Ghana's case, these privatisation plans have met considerable organised resistance from civil society, with the result that the World Bank has withheld $100 million of funds to the urban water sector – money which could have been used to address some of the grave access difficulties faced by the urban poor. This project is now expected to proceed from mid-2004, on the basis that a management contract is introduced in urban areas, with the Bank having moved away from its original position of wanting a lease contract or concession to be introduced. In part this is due to a lack of strong investor interest – undermining the key argument that privatisation would bring in additional foreign capital – but also because of the intense controversy surrounding the reforms (Joyner 2004).

Indeed, water privatisation has become such a live political issue in Ghana that it is increasingly difficult to find anyone who will openly claim responsibility for initiating the reforms. The World Bank claims that it is the government's policy, given that the Cabinet has now approved it, while government officials stress that the privatisation programme originated in the World Bank. This latter view is confirmed by the managing director of the state-owned Ghana Water Company: "The World Bank has been the lead agency. All the time they were leading the privatisation effort."[5]

Just as in Uganda, the World Bank has made privatisation a condition of releasing loans to Ghana's water sector. The General Secretary of the country's Public Utility Workers' Union confirms that there has been no ambiguity in the World Bank's promotion of the private sector option: "It's take it or leave it. Everyone is aware that this is a 'conditionality'."[6] This awareness has in turn undermined confidence in Ghana's structural reforms, as national decision-making processes are widely perceived to be subordinate to IFI conditions.

India

India provides a variation on the above theme. With aid equivalent to just 0.5% of GDP, India is far less aid dependent than most other low-income countries, and this fact – together with the World Bank's exposure to India – has reduced the IFI's ability to leverage policy change through conditionality. However, there is considerable World Bank conditionality in operation at the individual state level, exemplified by the electricity sectors in Orissa and Andhra Pradesh.

Orissa was the first state to agree to electricity privatisation in India, and until recently it was held up by the World Bank as a 'pioneer' model for other Indian states to follow. The state electricity board had an extremely poor track record as monopoly provider and Orissa, one of India's poorest states, faced a severe fiscal crisis in the early 1990s. As a result, it responded

[4] *Interview, December 10th 2003*

[5] *Interview, March 3rd 2004*

[6] *Interview, March 7th 2004*

to the World Bank's offer of financial assistance in exchange for sectoral reform. The reform programme supported by the Bank involved the passing of an Electricity Reform Act in 1995 and the unbundling of the electricity board's operations into separate entities, paving the way for privatisation of the power generation and distribution companies in 1999.

There is a widespread perception among key stakeholders that the privatisation programme in Orissa was both formulated and driven through by the World Bank – indeed, the reforms are routinely referred to within Orissa itself as 'the World Bank model'. As one consultant involved in the programme described it:

> "There's no doubting the decisive role played by the Bank in pushing the reforms – it's 100% a Bank model. Orissa had to accept the conditions, given its poverty, debt and the fiscal crisis in the state. There were huge problems in the sector, but Orissa was in an unusually weak negotiating position with the Bank compared with other states."[7]

Officials of the UK government's Department for International Development (DFID) in Orissa also confirm the "major role" played by Bank conditionality in driving the programme through.[8] Yet the privatisation, which was once lauded as a model, is now being branded a costly failure by many of those involved. The state government has seen its fiscal situation deteriorate still further as a result of debts incurred in the privatisation, while the private companies which took over electricity distribution breached their contracts by failing to invest any new working capital in the sector.

The privatisation has failed in respect of its performance too. Half of Orissa's population remain without power, while the $200 million of World Bank money spent on reducing transmission and distribution losses has had a negligible impact on their pre-privatisation level. In fact, the only area in which the World Bank's targets have been met has been in tariff increases for consumers: despite the lack of any discernible improvement in customer service, increases in electricity charges have averaged 15% for every year of the privatisation programme to date.

The World Bank based its power sector restructuring project for Andhra Pradesh on the Orissa model, including the unbundling of the state electricity board into separate generation, transmission and distribution companies, and its subsequent privatisation. Once again, DFID officials supporting the project confirm that privatisation was a condition of the World Bank's 10-year loan commitment of $980 million (out of a total project cost of almost $4.5 billion). The major difference from Orissa is that in Andhra Pradesh the Bank is making use of an Adaptable Programme Loan (APL), through which specific conditions must be satisfied at each stage of the privatisation process in order to release the next tranche of loans. These conditions include annual tariff increases of 15-20%, the privatisation of distribution and generation, and a reduction of government subsidies to zero.

As a result of these conditions, electricity charges have risen by 60-80% in agriculture and by 30-50% for domestic customers. Anger at the impact of these increases led to three months of mass protests in Hyderabad and other parts of Andhra Pradesh during 2000, with three deaths and 25,000 arrests – opposition which the World Bank says "must be overcome" (World Bank 2003a). Once again, attempts to stem transmission and distribution losses have been almost entirely unsuccessful, while services for rural users are now rationed to six hours a day. At least a third of all households in the state remain without electricity.

2.7 Cross-conditionality – magnifying the mistakes

The introduction of the PRSP process in 1999 was intended to provide each country with a national framework for harmonising government and donor efforts in support of poverty reduction. In theory, donor harmonisation behind a common set of country-led policies and programmes could do much to strengthen aid effectiveness and country ownership. It could also serve to substantially reduce the burden faced by recipient governments in negotiating, monitoring and reporting to different donor and creditor agencies.

[7] *Interview, March 3rd 2004*

[8] *Interview, March 3rd 2004*

2. Conditionality in the face of 'ownership'

In practice, however, harmonisation often means the alignment of all donor aid behind World Bank and IMF conditions. With the shift towards budget support, bilateral donors are increasingly using IMF programmes to indicate whether countries are pursuing 'sound' policies. In some cases, bilateral donors are explicitly tying their conditions to those of the World Bank, often by linking their conditions to those included within Poverty Reduction Support Credit loans. For example, in Orissa the World Bank recently delayed and threatened to cancel a $1.1 billion adjustment loan for the Orissa Economic Revival Programme, because of unsatisfactory progress on prior actions related to energy reforms. DFID, whose own assistance is aligned with PRSC conditions, has as a result also suspended the second tranche of its direct budget support to the state government. The late processing of the World Bank and DFID support has contributed to a situation in which the state government defaulted on interest payments to the Reserve Bank of India on bonds that had been issued under the donor-supported privatisation. In response, the government of India deducted $10 million from its annual transfer to the state government.

As the case of Orissa makes clear, the problem with such a system is that it can magnify the impact of IFI conditions, because governments risk being cut off from all sources of financial assistance – especially those coming directly into the budget – if they fail to follow IFI policy prescriptions. In effect, the IMF especially is given a superior position amongst the donors, acting as a 'gatekeeper' between the recipient country and access to external resources. Such 'harmonisation' can also substantially increase the volatility of aid flows, with donors suspending or releasing aid in one bloc. With some countries dependent on aid flows to finance half their budgets, such volatility brings serious risks.

The influence of cross-conditionality is particularly clear in the case of debt relief under the HIPC initiative. As with bilateral aid, remaining on-track with IMF programmes is a key condition for accessing debt relief under HIPC. Going off-track with the IMF results in delays in receiving debt stock cancellation and can even lead to the suspension of interim debt service relief. PRGF interruptions are the main reason why HIPC is so chronically behind schedule, with only 10 out of a projected 25 countries having fully passed through the initiative to date. Of the 17 queuing for debt relief, 13 have at some point gone 'off-track' with their PRGF, while in 6 of these cases PRGF interruptions resulted from delays in privatisation or 'reform' of state-owned enterprises.[9]

Bolivia provides a stark example of the pressures of cross-conditionality when imposed by regional as well as international creditors. The Inter-American Development Bank stipulated that Bolivia would qualify for its 2001 Social Sector Programme loan only if it stayed on track with its IMF programme, just as the World Bank's 2004 Country Assistance Strategy notes that failure to agree a new PRGF with the IMF will condemn Bolivia to low-case lending for the next two years. Given the anti-IMF protests in Bolivia during 2003, which left dozens dead and led to the eventual overthrow of the government, such 'harmonised' conditionality seems particularly irresponsible.

Cross-conditionality is still encountered in relation to individual donor projects too. When the World Bank withheld $100 million of financing for Ghana's urban water sector, DFID followed suit and withheld £7 million of its own. This official UK assistance, originally earmarked for the water sector in the city of Kumasi, but now available for urban water more generally, will be released at the same time as World Bank funds are released. As a senior DFID official working on Ghana's reform programme confirmed: "The only show in town since 1995 has been PSP (Private Sector Participation), so that's the one we are backing."

2.8 Soft conditionality – selectivity, policy advice and technical assistance

Although straightforward conditionality is widely employed by the World Bank to drive its reform agenda, it also recognises that conditions by themselves are a crude tool for promoting policy change (Koeberle 2003). Increasingly, the IFIs and other donors are using other, complementary influencing tools, alongside programme conditions to drive economic policy change. This includes strengthened

[9] *Source: HIPC Status of Implementation Report, Sept 2003, World Bank and IMF*

Box 4 DFID, conditionality and utility privatisation

While the IFIs are taking the lead in promoting the privatisation of essential services, bilateral donors such as the UK Department for International Development (DFID) are also applying pressure on recipient countries, both directly and indirectly.

As has already been noted, budget support from bilateral donors such as DFID often includes ‘cross-conditionality’, whereby countries are required to remain on-track with their PRGF programme in order to access aid. Amongst donors, DFID has been one of the leading proponents of direct budget support, which now accounts for 15% of all its bilateral aid. Effectively, this means that DFID aid comes with a whole raft of IMF conditions, including those related to basic service privatisation. In some countries, including Uganda, Vietnam, India, Ghana and Tanzania, DFID has gone even further, and explicitly incorporated World Bank conditions, including privatisation, into its own aid programmes as part of its on-going effort to promote ‘harmonisation’. In India, for example, DFID recently delayed a second tranche of its budget support to Andhra Pradesh until the World Bank approved a second ‘Economic Restructuring Project’ adjustment loan – which places strong emphasis on the state’s energy reforms.

DFID is also providing more direct support to the privatisation of basic services. For example, the Emerging Africa Infrastructure Fund, launched by the department in January 2002, is underwritten by DFID to the tune of $100 million. The Fund aims to mobilise up to $450 million for private investment in infrastructure projects in Africa. It has attracted backing from other donors as well as private sector financiers, and is designed to provide lending to privatisations of public services in African countries as well as new projects, with particular emphasis on the energy, telecommunications, transport and water sectors. DFID is explicit that the fund is open to private companies only; it will not provide any financing for public sector investment.

DFID has also been extensively involved in supplying privatisation consultants to developing countries, often within the ambit of ‘technical assistance’. In the Indian states of Orissa and Andhra Pradesh, for example, international consultancy firms have been paid by DFID to advise the governments on the implementation details of privatisation programmes. International investment bank Credit Suisse First Boston spent £20 million of DFID technical assistance funds in just six months in Orissa, while DFID provided £28 million of technical assistance funding in support of the first phase of the World Bank’s power restructuring project in Andhra Pradesh – much of it going to privatisation specialists PriceWaterhouse Coopers and Andersen Consulting (now Accenture). DFID funds have also paid for the Adam Smith Institute’s assistance to Ghana’s urban water restructuring project, and for a communications strategy in Tanzania to promote the benefits of utility privatisation.

2. Conditionality in the face of 'ownership'

use of selectivity – directing aid to countries that are judged to possess a 'sound policy environment' – as well as extensive use of policy advice and Technical Assistance (TA). TA expenditure in particular has grown rapidly during the 1980s and 1990s, and globally now accounts for $14 billion a year, or approximately one quarter of all aid (Oxford Policy Management 2003). Crucially, the use of this type of 'soft pressure' is in practice less transparent than conditionality, thereby allowing donors to make conditions less specific by 'unpacking' the implementation details of broad conditions through donor-financed analysis and planning. As a result, the involvement of external agents has often become more difficult to discern, even as their influence over the policy-making has arguably tightened through increasing involvement in setting the parameters of policy choice and through engagement in key structural reforms (Killick 2004).

As noted earlier, recent experience of the PRSP process has given rise to criticism that the World Bank and IMF were playing too great a role in directing the content of reforms. In particular, donor countries complained that the Joint Staff Assessments (JSAs) of PRSPs produced by the World Bank and IMF had such influence over borrowing governments that they effectively drew all attention away from assessments provided by others (IDA & IMF 2002). The Boards of the World Bank and IMF use these JSAs in judging whether to approve financial assistance and debt relief for developing countries, so their importance to borrowing governments cannot be overstated. Some government officials admit that they produce their PRSP with one eye firmly on the JSA that will evaluate it. This in turn risks 'self-censorship' by governments committing only to those reforms which they know the IFIs will fund. As one finance minister explained: "We do not want to second-guess the Fund. We prefer to pre-empt them by giving them what they want before they start lecturing us about this and that. By so doing, we send a clear message that we know what we are doing – ie, we believe in structural adjustment." (Fantu 2001).

In addition to the JSA, the World Bank and other donors are making increasing use of new selectivity tools to drive utility privatisation and other structural economic reforms, in particular the World Bank's Country Policy and Institutional Assessment (CPIA). The CPIA is a 'scorecard' that rates low-income country governments on a scale from A-F, using 20 indicators, including structural policies such as the provision of a 'competitive environment for the private sector'. The final score, which is not usually made public, now counts for 80% of a country's overall rating, used to decide how much money the World Bank will lend (the performance of the Bank's portfolio counts for the other 20%) (Alexander 2004). Although the CPIA measures past performance, the dividing line between the rating and ex-post conditionality is blurred: Country Assistance Strategies pick up areas defined as weak in the CPIA, and the World Bank is starting to link it closely to adjustment loans. For example, the Bank has recently discussed privately Kenya's CPIA rating with the government, in the context of the measures that must be taken to move towards a PRSC. This raises the possibility that countries will be pressed to undertake de facto prior actions before loans are agreed, with conditionality becoming less transparent or recorded (Joyner 2004).

'Technical assistance' to developing countries is also being widely used as a means of steering governments towards favoured policy choices. In one of the most high-profile current initiatives, the World Bank and IMF have teamed up with the World Trade Organisation (WTO) and other agencies in the Integrated Framework for trade-related technical assistance to least developed countries, carrying out diagnostic studies which are explicitly linked to the countries' PRSPs. In several cases these studies have recommended privatisation of state-owned enterprises, as in Senegal's rail, energy and groundnut sectors or Burundi's coffee, tea and cotton sectors. The diagnostic study on Madagascar recommends a wholesale redefinition of the role of the state, with priority privatisation of Air Madagascar, telecoms company TELMA and the national cotton and sugar parastatals, plus further World Bank assistance with studies into water, electricity and other privatisations during 2004-05.

Such technical assistance is not confined to structural studies at the macroeconomic level, but has become increasingly common at the individual project level too. And once again the assistance can prove far from neutral in respect of its preferred options. Privatisation specialists Pricewaterhouse Coopers have acted as World Bank consultants to the Indian state of Orissa since 1995, and actually drafted the 1995 Electricity Reform Act that set the stage for privatisation of that sector; in all, foreign consultations to the Orissa power sector have received a massive $110 million from donors and IFIs. Likewise, the foreign consultants appointed to produce preliminary studies for the restructuring of the water sector in Ghana have included US consultancy Louis Berger and the UK's Adam Smith Institute, both known for their ideological commitment to privatisation (Wilks and Lefrançois 2002).

As well as using indirect means to convince developing country governments of the 'correct' approach that will win donor approval, many of the policies leading to privatisation are concealed within other projects – particularly those relating to decentralisation. For example, privatisation of water supplies and waste management was part of the World Bank's 2001 programme for decentralisation in Bolivia, just as privatisation at the commune level was made a trigger condition for release of funds under the World Bank's National Rural Infrastructure Project 2000 in Mali. Restructuring programmes can also introduce measures leading towards privatisation, such as the creation of 'enabling conditions' for greater private sector involvement. Tanzania provides one such example, where the World Bank made its 2002 Rural Water Supply and Sanitation Project conditional upon restructuring of the rural water division within the Ministry of Water and Livestock Development by the end of 2004. The Ministry's role was also to be redefined so that it would act as an 'enabling agency' for NGOs and private sector operators in the future.

Brett Eloff/Panos Pictures

3. Water and energy privatisation – economic policy conditions hit the ground

Reliable supplies of clean water and energy are critical to the well-being of poor people, and strong links have been established between investment in these infrastructure services and poverty reduction, particularly where services are designed to address the needs of the poor (Willoughby 2002). Yet huge numbers of people in the world's poorest countries lack access to these basic services: more than one billion people go without access to clean water, and more than double that number have no access to electricity (UN 2003, IEA 2002). Although publicly owned utilities in developing countries have rapidly expanded water and electricity infrastructure since the 1950s, in many cases this expansion has recently slowed or halted. At the same time, many utilities are inefficient, weakly regulated, prone to political interference and neglectful of the poor. These problems, and the need for additional investment in basic infrastructure in poor countries, are real and urgent.

However, the experiences discussed in this chapter suggest that these problems are unlikely to be straightforwardly solved by a shift of ownership or management from public to private hands. Yet the IFIs and other donors continue to cite public sector failings as a rationale for utility privatisation (World Bank 2004, 2003c, DFID 2002a). At times, frustration with failed attempts at public sector reform, coupled with a series of untested assumptions about the superiority of private sector solutions, seem to have led many donors to treat private sector involvement as a proxy for efficiency gains (see box 5). The current donor preoccupation with attracting private capital, often driven by a narrowly economic analysis of service failure, also risks subordinating public benefits to financial objectives. As the evidence in ActionAid's case studies shows, poor people's needs and priorities have been largely missing from discussions about utility reform.

At best, poverty considerations tend to be deferred as a longer term problem to be resolved once financial and institutional concerns have been addressed, or to be bolted on in the form of limited safety net provision (WaterAid 2003, Dubash 2002). More fundamentally, privatisation conditions raise questions about whether donors should be pushing their preferences so strongly in poor countries in the first place, given the evidence that economic policy conditionality distorts domestic decision-making processes and that the reforms are by their nature risky and controversial.

Box 5 Privatisation: what's in a name?

IFIs and donor governments have drawn strong criticism for their attempts to restrict use of the term 'privatisation' in the debate over public services reform. The World Bank claims that privatisation means only the full divestiture of public assets to the private sector, but according to this definition, very little privatisation has taken place in either the water or energy sectors (in the case of water, England and Wales and Chile are the only countries where a full transfer of assets has taken place). For other cases, even where control over services is fully transferred to the private sector, the IFIs prefer to use less contentious terminology such as 'private sector participation', or its harmless-sounding acronym PSP. In ActionAid's view, a more meaningful definition of service privatisation would cover situations where the private sector has assumed management responsibility and substantial control has been taken out of public hands. In many cases this transfer of control is handed over to the private sector in long-term concessions lasting decades, or through lease and management contracts. It is this definition of service privatisation that is employed throughout this report.

3.1 The evidence that water and energy privatisation are failing the poor

Who pays?

Ultimately, people must pay for a service, either as taxpayers or service users. Private investment in utilities (like water and energy provision) may represent a new source of financing and thus relieve the immediate burden on the public purse, but it does not represent additional funding. Ultimately someone still has to pay for the services, and as a result of privatisation and full-cost recovery programmes, this burden falls increasingly on consumers. The World Bank has acknowledged that this is an inevitable consequence of pursuing utilities privatisation for fiscal reasons – and that the ensuing rise in tariffs will cause particular hardship for the poor (Estache et al. 2001).

This increase in user charges has been a standard feature of utilities privatisation in country after country. While some of these tariff increases have been necessary in order to place utilities on a more financially sustainable footing, this is only a part of the story. Private sector water companies need to turn over a profit from their investments, as well as meeting the costs of borrowing on international capital markets, and this will be reflected in tariffs where it is not offset by efficiency gains. Liabilities amassed in the course of restructuring programmes are also passed onto users in increased charges. For example, in Andhra Pradesh, annual repayments on borrowing resulting from the power restructuring project will average $440 million between 2005 and 2010 – equivalent to one quarter of sector revenues. Profit guarantees to private operators – for example, of 16% to distribution companies in the energy sector in Orissa, India, and of 15% over 40 years in the case of the Cochabamba water privatisation in Bolivia – are also reflected in tariff rises. These are far in excess of the 6-10% profit margins expected by private sector utility operators in OECD companies (de la Motte 2004).

Crucially, the impact of these rises on the poor has often proved extremely damaging. Where poor families are connected to the system, they may have to forego clean water or electricity usage as a result of not being able to pay the increased charges. Alternatively, households can be forced to cut expenditure on other essentials as a result of the 'substitution effects' of meeting higher tariffs – including rationing basic food expenditure or withdrawing children from school (WaterAid 2003b). Where households are not connected to the system, high tariffs can act as a major deterrent to connection, as can the high cost of connection itself.

The water sector provides vivid illustration of the scale of price increases introduced by companies after privatisation. In Conakry, Guinea an increase of 500% by French multinationals SAUR and Vivendi took place in the period between 1988 and 1996 – rates were eventually considered so high that the government declined to renew the contract. In Manila, capital of The Philippines, prices have increased by 200% since privatisation in 1997. Prices increased by between one third and one half following water privatisation in Tucuman province in Argentina, Jakarta in Indonesia and Cochabamba, in Bolivia (Hilary 2003).

In the Colombian city of Cartagena, for instance, transferring the water supply system to a new joint venture with the private sector was the condition for unlocking a $85 million World Bank loan which in turn financed the connection of several poorer districts to the water network. Yet repayment of the loan will entail estimated price rises of 20% year on year for the rest of this decade, on top of tariff increases of 200% which have already been introduced over the past eight years. The fact that such increases will be unaffordable for Cartagena's many poor families has raised fears for the sustainability of the city's previous achievements, at a time when non-payment of bills is already a growing problem (Nickson 2001).

The electricity sector has seen similar increases in tariffs upon privatisation, as shown in the Indian examples detailed in the previous chapter. In the Dominican Republic, electricity prices increased by 50% when the generation plants and distribution networks were privatised in 1999. In this instance, however, the government attempted to shield consumers from the

3. Water and energy privatisation – economic policy conditions hit the ground

impact by absorbing almost half of the price increase itself, at the cost of $5 million per month – a fiscal burden it was unable to sustain. Once the government was more than $100 million in arrears in its payments, the private sector power companies began to ration power supplies, causing daily blackouts and cutting off electricity to businesses, hospitals and schools. This in turn provoked a widespread protest campaign of non-payment of electricity bills (Bayliss 2001).

Access

Many of the poorest households, especially those in rural areas, remain unaffected by tariff rises because there is no access to water and electricity. ActionAid's research suggests that private sector involvement in utilities has done little to remedy this situation. In Orissa, after almost a decade of donor-financed power sector restructuring, there has been no new rural electrification and half of the population go without power. In fact, the rural electrification wing of the state electricity board was disbanded at the point of privatisation, an action strongly criticised in a 2002 government committee enquiry into the reforms (Kanungo 2002). A similar situation exists in Andhra Pradesh, where no new rural electrification has so far taken place as a result of the power restructuring plans. One NGO that has followed the process closely, Lok Satta, observed that, 'reforms are not being targeted at poor people, partly because pro-poor reforms are seen purely as an investment issue, and therefore as a fiscal problem in the current climate'.[10]

In the case of Uganda's water reforms, ActionAid found that both the government and the donors involved in the sector are keen to emphasise that private sector management of urban water services has led to increased efficiency through improved billing rates, revenue collection and reductions in unaccounted for water. While this might be true, it tells us nothing about the number of poor households that have either lost or gained access to safe water supplies as a result of the ongoing reforms. Again, the complete absence of poverty disaggregated data on coverage extensions in the urban areas only suggests that the World Bank and its partners are more concerned with increasing financial efficiency than improving the quality of life of the poor.

3.2 Why does privatisation often fail the poor?

Starting with the wrong focus

Much of the negative impact of utility privatisation stems from the motivation that lies behind it. Privatisation is rarely introduced with the explicit aim of supplying better services to poor people, but almost always in order to address problems facing the public purse. For example, in the case of the Orissa power reforms, the World Bank's staff appraisal document states, 'not applicable' under the heading 'poverty' in its programme summary. As one consultant involved in the reforms stated: "Poverty was simply not a factor in design – the reforms were totally market-driven".[11] One DFID official working in Orissa concurred that "poor people were left out of the equation" and that the state's fiscal crisis had framed the reform programme.[12]

In some cases, government authorities have hurriedly introduced privatisation in order to relieve the burden on public sector finances – particularly in the context of economic crisis, as in the electricity reforms of Argentina and Indonesia (Dubash 2002). In other cases the IFIs have themselves demanded privatisation for budgetary reasons – as happened in Peru, where the Arequipa electricity privatisation was pursued in the context of an IMF condition requiring a sharp reduction in the fiscal deficit, to be achieved partly by raising $700 million from asset sales.[13]

To the extent that poverty has figured as a concern in the design of utility privatisation, it has often been justified on the basis that the once government is freed from the fiscal burden of state owned and operated utilities, it will be able to spend more on health,

[10] *Interview, March 6th 2003*

[11] *Interview, March 4th 2003*

[12] *Interview, March 3th 2003*

[13] *The Economist. June 22nd 2002. 'Arequipa's anger, Peru's Problem'.*

Box 6 Testing the claims about utility privatisation

IFIs often justify their promotion of utility privatisation with a series of arguments contrasting public sector failings with supposed private sector efficiency. There is no doubt that in some countries the public sector has not provided the services expected of it. Yet on closer inspection, many of the key claims made for privatised utilities are weak or non-existent, strengthening the case for donors to step back from conditions in this area.

More efficient?
The most common argument in favour of utilities privatisation is that a private company will be more efficient than the public sector in managing services. Yet a series of studies have found this not to be the case. The World Bank's most recent evaluation of its own water projects confirms that the public sector has achieved the same level of efficiency as the private sector, with marginally higher achievement in the provision of new connections to the water network (World Bank 2003b). This reinforces the conclusion of an earlier international study of electricity companies, which established that there is no difference in efficiency between private and public operators in that sector either (Pollitt 1995).

Less corrupt?
Claims that the private sector is less corrupt than public utilities have been tempered by the high-profile corporate fraud scandals of recent times. Yet utility multinationals have been implicated in corruption cases for many years, with executives of some of the most famous corporations being convicted of bribery in obtaining contracts (Hall 2002). Moreover, it has been widely observed that privatisation has the potential to increase the incidence of corruption, as corporations use illicit payments to seek favours in the tendering process or in negotiation of the contracts under which they are to provide services in future (Rose-Ackerman 1996).

Taking on risk?
The argument that privatisation of public utilities will transfer risk to the private sector has been exposed as a myth. In many cases, companies are negotiating themselves guaranteed profits, regardless of performance. For example, in 'take or pay' arrangements, private suppliers are guaranteed payment for output whether or not it is needed, as in Indonesia (de la Motte 2004). In other cases private companies have secured guaranteed returns. In the water concessions of Buenos Aires and Manila, the companies also managed to transfer foreign exchange risk straight back to consumers, placing an extra burden on the poor (Hilary 2003). Indeed, wherever privatisation is not proving as lucrative as planned, the companies can put pressure on the authorities to renegotiate the original deal: one study of Latin American countries revealed that as many as 71% of all water concessions were renegotiated during the 1990s (Guasch et al. 2002). And if that doesn't work, companies have shown that they are quite prepared to walk away from their responsibilities – and then sue for compensation through the World Bank's International Centre for Settlement of Investment Disputes.

Leveraging additional finance?
The contribution to investment in developing country utilities from Foreign Direct Investment (FDI) has been less than expected by market enthusiasts, and much less significant for developing countries than capital investment within the countries themselves. Because of fears about risk, few private corporations bring significant shareholder money to privatised utilities. FDI may not even be additional investment, especially where government guarantees are used, as the country's international credit exposure will limit the acceptable total of guaranteed international loans underwritten by the government (de la Motte 2004).

Benefiting the poor?
The most counter-intuitive claim in favour of privatisation is that the private sector will be better able to target its services to the poor. While it is true that the public sector has often failed to serve the interests of poorer communities, the private sector's need to secure returns on its investments has always led it to direct its services to where people are able to pay. Where privatisation has led to an expanded service for poor people, this has almost invariably happened through public subsidy (de la Motte 2004).

3. Water and energy privatisation – economic policy conditions hit the ground

education and other basic needs.[14] Yet evidence to back this claim has not been forthcoming. Indeed, the amassing of debts through privatisation often has the opposite effect. In energy, where state utilities have been unbundled into separate entities, existing debts are often loaded onto those parts of the sector remaining in public hands, in a bid to attract private capital.[15] Similarly, in the case of water, investment responsibility is increasingly left in public hands – as is being proposed for the urban water sector in Uganda – out of a recognition that multinational companies are reluctant to bring their working capital to the sector (see below).

This focus on fiscal relief rather than providing universal services means that 'success' with utilities privatisations has come to be measured more by the amount of private capital mobilised than by their impact on the poor. The World Bank's most recent evaluation of its own electricity privatisation projects makes this point strongly, criticising the Bank for its "neglect" of the impact of privatisation on poor people. In an embarrassing conclusion for an institution whose *raison d'être* is poverty reduction, a review of 154 World Bank projects in the electricity sector found that they offered "very little data to evaluate the impact of power sector reforms on the poor" (World Bank 2003a).

The World Bank admits that it has also failed to address the poverty implications of its water programme. The Bank's evaluation of its record in the water sector concludes that it has failed to align water resources management with its own poverty strategy, has been ineffective in expanding access in rural areas and has failed to address gender issues relating to water (World Bank 2002b). Yet despite these findings – and an admission that it has "proved hard" to get the private sector to focus on the alleviation of poverty as an objective – the World Bank's new Water Resources Sector Strategy calls for renewed effort from all World Bank Group members to mobilise private capital into the water sector, including direct IFC financing in those cases where commercial investment is not feasible (World Bank 2004).

Privatisation requires high regulatory capacity
There is broad consensus that privatisation of state enterprises should not be undertaken without first establishing adequate capacity to regulate the new companies involved. This sequencing is doubly important where a public monopoly is to be replaced by a private monopoly (usually a multinational), as is commonly the case for utilities such as electricity and water, and true competition is missing.

Yet the financial and technical cost of effective regulation – which needs to be factored into any comparative analysis of the cost-efficiency of public and private provision – is often overlooked in restructuring programmes. Although many of these regulatory costs also exist in the public sector, the potential conflict between the priorities of social development and the profit motive of private companies makes it doubly important that regulators are able to enforce tariff regulations, quality standards and welfare concerns according to changing economic circumstances (Ugaz 2001a, Rees 1998).

Yet it is also widely acknowledged that few developing countries currently have the capacity to create regulatory systems of sufficient strength and sophistication to meet this challenge. Past experience provides evidence of how damaging this can be to developing countries, and especially to the poor (Madeley 1999). For example, in the water sector when regulators have been threatened with the unilateral termination of operations by the private sector service provider, they have often been left with little choice but to relax their performance requirements on the company or raise user charges as requested. As a result, the private companies have often sidestepped their obligations to extend services to marginalised communities, while regulators have sanctioned repeated increases in water tariffs which have taken a disproportionate toll on the poor.

An example of this situation can be found in the Bolivian cities of La Paz and El Alto, where an apparently pro-poor concession agreement and the

[14] *Letter from DFID Andhra Pradesh programme to ActionAid, January 27th 2004: 'The restructuring and privatisation of loss-making enterprises has freed up resources which the government has spent on schools, health centres and roads.'*

[15] *This has happened in Andhra Pradesh, where the state power generator has taken on pension liabilities of over $1bn. This has contributed to book losses in India's most efficient power generator (in terms of Plant Load Factor) of some $290m in 2002/3.*

establishment of a legislative and regulatory framework failed to guarantee affordable water and sanitation services for all sections of the population when water services were privatised in 1997. As one observer has argued, Bolivia's 'Law on Water Supply and Sanitation' and the establishment of an independent regulatory body constitute key steps in the right direction, but have so far been unsuccessful in terms of extending improvements in access to water and sewage services to the poorest sections of the population (Carrasco 2002). In Orissa, similar problems emerged following the super-cyclone in 1999, when the multinational power distribution company AES failed to meet its commitment to restore power to 19,000 affected villages within six months, and then refused to pay the fine imposed by the regulator, claiming that it was uninsured against the cyclone damage. AES subsequently withdrew unilaterally from the management of the distribution company (de la Motte 2004).

3.3 Positive alternatives to privatisation

The promotion of privatisation blueprints by IFIs and donor governments is often backed by the claim that there is no viable alternative to increasing private sector involvement in utilities, and that the alternatives have all been tried without success. As one DFID official working on power sector reforms put it, 'expecting a government-run industry to be efficient is a triumph of hope over experience'.[16] Yet there is an established range of alternatives which have proved both successful and sustainable in bringing electricity and water to even the poorest communities, and which have addressed many of the accountability shortfalls associated with large-scale concessions and contracts.

Community-based initiatives, grounded in the needs of local people, are one response to the failure of conventional restructuring programmes to deliver on poor people's priorities. Community-based projects – especially in water – have demonstrated their importance in providing sustainable electricity and water to the poorest and most remote communities, which are commonly not served by national networks (ITDG and Greenpeace 2002; Calaguas 2003). In rural areas particularly, some donors are showing an interest in supporting this approach. However, while small-scale, community-based initiatives have often delivered value for money, they are not without risks and usually depend on subsidy for their operation (Colin and Lockwood 2002). The dangers of moving to scale too fast, or expecting too much of poor communities are apparent in Uganda, where rural water provision has run into sustainability problems as 'Community Driven Development' has placed growing responsibility on some of the poorest communities for construction and maintenance of basic infrastructure.

Small-scale private sector water providers (vendors and resellers) are also being increasingly used as an alternative, particularly in Africa. Where there is no formal water supply to slums they are sometimes seen as a short-term way of providing water to some of the poorest urban dwellers. Again, they are not a solution in every setting, and without effective price regulation their impact can be anti-poor (de la Motte 2004, Solo 2003).

Another set of alternatives is found in a range of reforms that have been used to revitalise public sector provision of utilities. Where public services have been refocused on providing accountable and efficient services for all, significant success has been achieved (Hall 2001). The answer may be for the public sector to become more not less public, insofar as enhanced political accountability to citizens (and not just economic accountability to consumers) is necessary to strengthen efficiency and equity in service delivery. Several recent successful reforms aimed at improving efficiency through political accountability to service users, including Kerala, India, Porto Alegre in Brazil, and the Orangi pilot sanitation project in Pakistan, make a strong case for this approach to be used more widely (de la Motte 2004).

Given the widespread failure of recent restructuring programmes in water and energy to deliver sustainable benefits to poor people, it is clear that these alternative models of community-based or public sector provision at least need to be considered. While the private sector has a role to play in expanding access to water and

[16] *Letter from DFID India to ActionAid, March 15th 2003*

3. Water and energy privatisation – economic policy conditions hit the ground

energy, recent experience suggests it will be a smaller and more specialised role than many donors have pushed for through their aid programmes. A far more balanced debate, led locally and separated from the use of donor conditions, is needed to identify the precise mix of public and private involvement necessary to deliver effective services to all.

What the companies say

Significantly, donor enthusiasm for utility privatisation in low-income countries is increasingly coming up against a more realistic attitude from the private sector companies themselves, whose executives now downplay suggestions that their intervention will transform the water and energy sectors. Echoing earlier comments made by chief executives of French water multinationals Suez and SAUR, Thames Water's chief operating officer Jeremy Pelczer told a London conference on water and sanitation in February 2003 (Hilary 2003):

> "Private sector participation is not a panacea. If it has been oversold in the past, it is important that this is corrected now."

Indeed, the World Bank now admits that it has been guilty of "unrealistically high expectations" of what privatisation has to offer in the water sector (World Bank 2003b). Even those companies that stand to gain most have spoken out against the continuing use of such conditionality: Thames Water, for instance, has on several occasions condemned the imposition of water privatisation as a condition of IFI loans. On the basis of recent experience, one study of the role of the water multinationals in developing countries has concluded, 'there is no justification for international agencies and agreements to actively promote greater private sector participation on the grounds that it can significantly reduce deficiencies in water and sanitation services in the South' (Budds and McGranahan 2003).

In the electricity sector too, there has been a growing realisation that the private sector will have only a small part to play in bringing finance to address the unmet needs of more than two billion people. International power companies have been reassessing their exposure in developing countries, and many have withdrawn investment from key projects in recent years (World Bank 2003a). The International Energy Agency recognises that private companies will not extend electricity services to rural areas where it is unprofitable to do so, and has recommended that such areas would be best served by community-based projects instead (IEA 2002).

Mark Henley/Panos Pictures

4. ActionAid's conclusions and recommendations

The use of aid conditionality to push risky and unproven economic policy reforms such as privatisation has persisted into the PRSP era, despite claims that PRSPs replaced coercion with partnership, mutual accountability and national ownership. Recent efforts to increase the 'policy space' for poor countries are important. But they have only been partially implemented, and in any case do not go far enough. The IFIs retain the final say over whether policy is appropriate, aid continues to be used to leverage changes donors believe would not otherwise take place, and the content of reforms remains largely unchanged. While donor agencies have a valid role to play in an open dialogue with countries about policy alternatives, this is not currently happening. In the case studies discussed in this paper, donor conditions have placed unduly tight parameters around the reform options, while through technical assistance donors have sought to define policy goals on behalf of governments.

ActionAid believes that it is time for donors to make good their commitment to put poor countries in the 'driving seat' of reform, as the arbiters of policy change. To make this happen, genuine space must be created, at national and international levels alike, to debate the best use of financial assistance to developing countries. To this end, ActionAid calls on the World Bank, IMF and donor governments – including the UK government – to undertake a radical reorientation of their use of conditionality, including the following key elements:

1. There should be an end to the practice of tying IFI loans and bilateral aid to the privatisation of utilities or other economic policies. Conditionality must be restricted to what is necessary to ensure that aid is spent on its intended beneficiaries, and not used as a lever to press specific policy choices on recipient countries.

2. The way technical assistance is planned and delivered needs to be reformed to ensure that it responds solely to the demands of the recipient country. Technical assistance should not be used to steer decision makers in the direction of predetermined reforms, but should support local capacity and explore policy alternatives.

3. More than three years after the Fund embarked on conditionality streamlining, and well into the second generation of Poverty Reduction Strategy Papers, there should be a fully independent review of the use of economic policy conditionality by IFIs and bilateral donors. It should focus in particular on the impact of policy conditionality on poverty reduction and democratic ownership of policy choices, and include an assessment of the impact of conditionality relating to the privatisation of utilities. It should also examine the use of technical assistance by IFIs and bilateral donors to direct developing country governments towards particular policy choices. This review should be supported by the IFI boards, and carried out by external experts.

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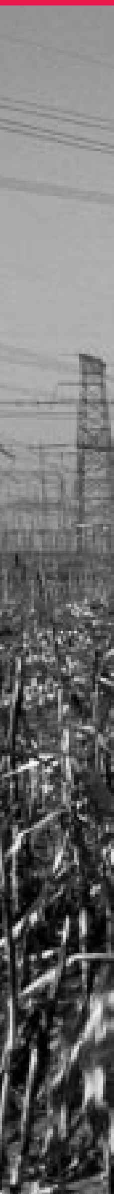

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