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***REFORMING WATER SERVICES:
THE KEY ROLE OF MESO-INSTITUTIONS***

‘Innovative approaches to performance for urban water utilities’

Mines-Agroparistech, 03-09-2014

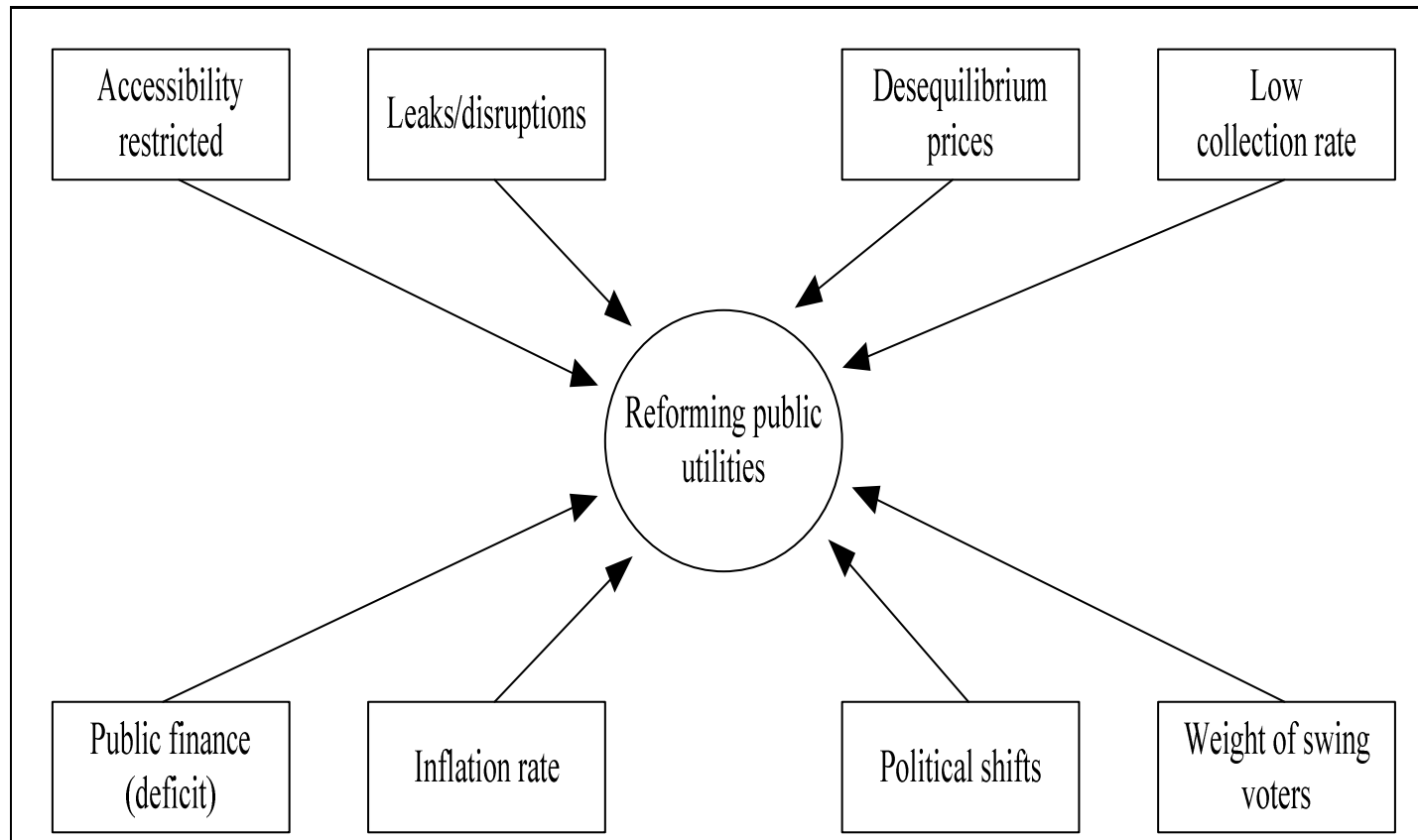
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INTRODUCTION
and
SUMMARY OF ARGUMENT

REFORMING WATER SERVICES: THE KEY ROLE OF MESO-INSTITUTIONS

1: Reform of urban water systems: forces at work



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2: Direction of reforms adopted since 1990s: PSP

High expectations from Private Sector Participation:
contract as optimal solution

3: Significant failures

- High rate of renegotiations (Guasch, 2004)
- Increasing reluctance of operators to support risks
- Donors squeezed between operators and policy-makers, which challenges consistency
- Even breach of major contracts (e.g., Buenos Aires, Manilla, etc.)

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4: BETWEEN ORGANIZATIONAL AND INSTITUTIONAL LEVELS: MISSING LINK

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5. Central argument:

MAJOR ROLE OF **MESO-INSTITUTIONS**
IN EXPLAINING SUCCESSES AND
FAILURES OF REFORMS OF PUBLIC UTILITIES,
INCLUDING WATER SERVICES

→ Related to **key issues of:**
DESIGN AND ENFORCEMENT

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6. POSITING MESO-INSTITUTIONS



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I:

WHY WATER SECTOR IS SO HIGHLY
REGULATED
AND
WHY IT **DIFFERS**
FROM OTHER NETWORK
INFRASTRUCTURES

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I.1: WHY IS WATER SECTOR SO HIGHLY REGULATED

-> beyond traditional arguments ...

(a) Economies of density/scale:
= pushing towards integration

(b) High level of sunk costs
= high risks for investors

(c) Low marginal costs
= strong incentive for under-pricing

(d) Users <-> voters
= politically highly sensitive

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II.2: WHY IT DIFFERS FROM OTHER NETWORK INFRASTRUCTURES

-> Problem of allocation of rights over a
resource that is highly decentralized

(a') decision rights:

degree of decentralization of
control/coordination restricted

(problems of externalities: health, leakages, ...)

(b') property rights:

degree to which strategic resources can
be transferred highly constrained

(problem of acceptability/legitimacy: “public
values”)

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II.3: MAKES IT A **CRITICAL INFRASTRUCTURE**

What is a critical infrastructure?

“ A set of interdependent assets forming a network that is essential to a society for guaranteeing to its citizens that fundamental needs are met.”

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II.4: CRITICAL INFRASTRUCTURE: CHARACTERISTICS

Conditions that 'criticality' imposes:

- > Adequate **scope of control**
(technology: of pumps and pipes!)
- > Accurate **coordination**
(Mix of control mechanisms needed to coordinate)
- > **Reliability** of the system in satisfying essential function
(water has no substitutes: prob. of leakages etc.)
- > **Viability** of the system
(network properties + long run sustainability)

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II.5: HENCE KEY ISSUE OF GOVERNANCE

Governance: process through which rights and assets are allocated and transactions are established, implemented, and monitored
=> transaction costs (economics/political) in urban water sector can be very high

This governance problem, typical of (although not exclusive to) urban water sector, is largely **monitored through meso-institutions**

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III:

WHY TO FOCUS ON MESO-INSTITUTIONS AND WHAT THEY ARE

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III.1: WHAT ARE MESO-INSTITUTIONS?



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III.1: WHAT ARE MESO-INSTITUTIONS?

„Political institutions will be stable only if they are supported by organizations with an interest in their perpetuation. Therefore, an essential part of political economic reforms is the creation of such an organization“

(Douglass C. North, 1992)

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III.1: WHAT ARE MESO-INSTITUTIONS?

CONCEPT: mechanisms of governance at the
interface between the general rules of the game
(delineating the institutional framework)
and the actors (operating within this framework
and submitted to these rules)

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III.1: WHAT ARE MESO-INSTITUTIONS?

Hence, two dimensions of their activity:

(1) VERTICAL: guaranteeing coherence between
general rules and operational entities

(2) HORIZONTAL: guaranteeing coherence between
institutional rules and technological
properties

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III.2: WHY TO FOCUS ON MESO-INSTITUTIONS?

KEY ROLE

(a) EX ANTE: designing/drawing actual arrangements (contracts) more or less well-embedded in existing rules

(b) EX-POST: main actor in enforcing arrangements and in solving conflicts (conflict resolution devices)

(In what follows, I focus essentially on this second aspect)

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III.3: ILLUSTRATIONS:

A)) EX ANTE-EX POST

- PUBLIC BUREAUS
- REGULATORY AGENCIES

B)) EX-POST

- MEDIATION (semi-formal arrangement)
- ARBITRATION
- COURTS

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III.3: MAIN PROBLEMS

→ RISKS OF **CAPTURE** and/or **CORRUPTION**

→ INTRODUCTION OF **ASYMMETRIES** IN
NEGOTIATIONS/RENEGOTIATIONS

(particularly when markets are concentrated in the hands of a small number of firms while public decision-makers are decentralized)

→ **DISRUPTIVE**

(particularly with 'judicialization')

=> **HIGH TRANSACTION COSTS**

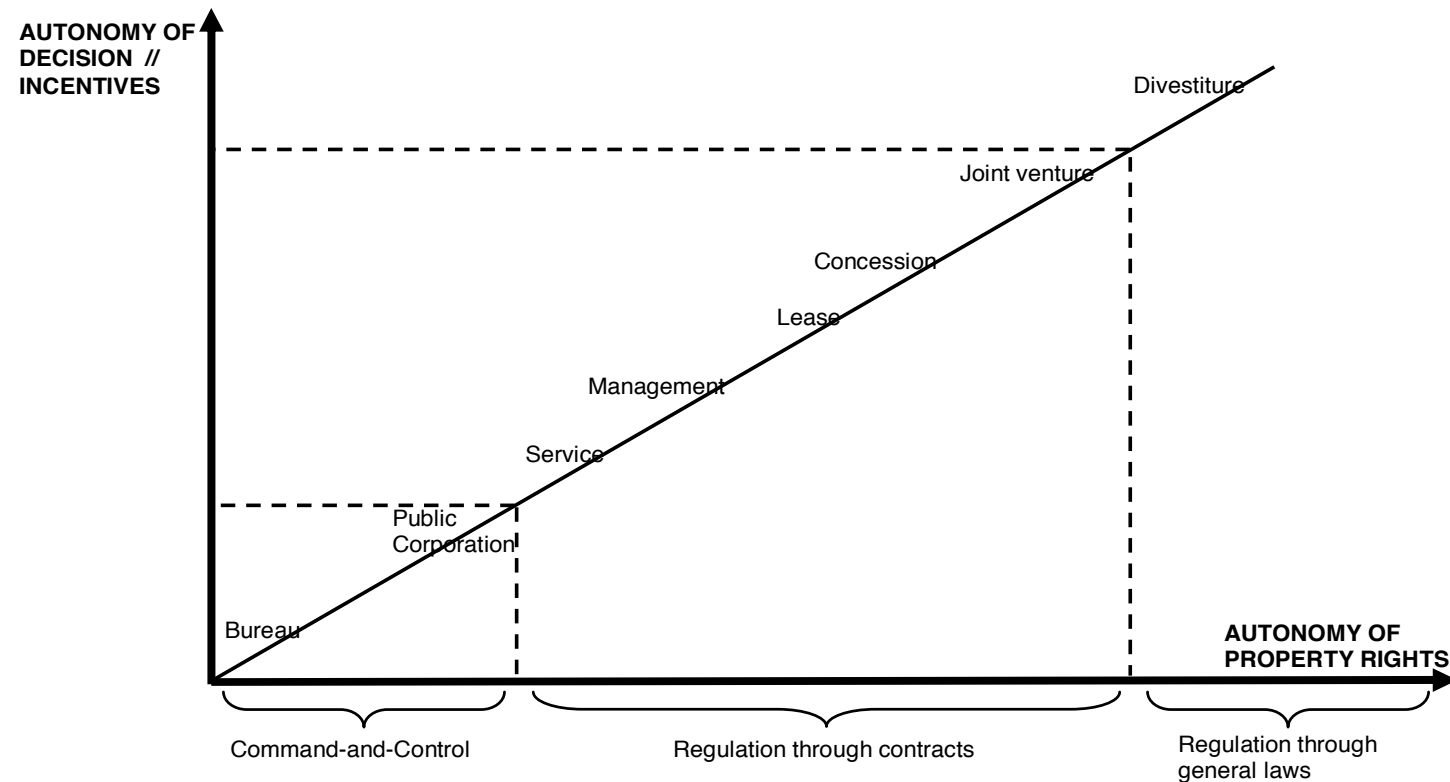
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IV:

REGULATION AS A MESO-INSTITUTION

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IV.1: REGULATION AS CENTRAL MESO-INSTITUTION: WHAT FORMS?



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IV.2: EVOLUTION?

From an **administrative** ('command-and-control') approach to a **contractual** approach to regulation (associated to development of PSP)

→ NOT to be overstated:

- * Gassner & al. (2009) : 837 out of 973 entities remain SOE
- * PWC (2005): Slow progress of PPP (ex. of EU: of 16 member states, only 3 had **significant** PSP: UK, FR, Portugal – and even these need qualification)
- * Guasch (2004): Very slow progress in LA

→ NEVERTHELESS an important evolution

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IV.3: SIGNIFICANCE IN WATER SECTOR:

*Key role of **local and regional meso-institutions** in designing and monitoring organizational arrangements (and contracts) in water sector*

→ MAJOR CONSEQUENCE:

If meso-institutions are key players, **availability of 'civil servants'** (as an asset) is a major issue

H 1: The more specific a meso-institution is, the denser is the required pool of qualified human assets

=> need to shift analysis from contractual design to building of human assets

=> need to pool capabilities (Basin, regional agencies ...)

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IV.4: ILLUSTRATION

Ongoing studies on impact of *Centralized vs Federal* political systems on choice of organizational arrangements (e.g., contracts) and their monitoring (Weingast et al; Ménard et al)

H 2a: Centralized systems design more standardized contracts and select more concentrated operators

Corollary: Corruption of higher amplitude (although not necessarily more frequent).

H 2b: Federal systems select more diversified modes of governance and less concentrated operators

Corollary: Corruption of smaller amplitude (more diffused, e.g. 'patronage'), but tends to be more diffused

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IV.5: DIFFICULTIES IN IDENTIFYING/ASSESSING SOURCES OF PROBLEMS

Vertical dimension: multiplicity of layers

- Different levels of government involved
- Technological constraints vs contractual constraints
- Abundance (and importance) of 'transmission wheels'

Horizontal dimension: multiplicity of principals

- Operating in parallel

Ex of Manila: 32 bureaus and agencies (Wung Xu)

- Political interferences and consequences on TC

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V:

CONCLUSION

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- (1) **Difficult alignment** between general rules (institutions) and operators (organizational arrangements): Key problem of meso-institutions
- (2) **Difficult issues of design and, above all, of enforcement**: Key problem of human assets

(In water sector, is the answer: go regional?)

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(3) Increasing concern about **credibility**:

-> propensity to transfer main risks to public authorities:
private operators as managers?

=> How to avoid micro-management by meso-institutions?

(4) **Political dimension must be assessed** in a less negative perspective than usually done

→ Role of politics unavoidable in sectors such as water

→ Voters and users systematically overlap

→ Essential needs => critical transactions

=> How to frame political interferences?

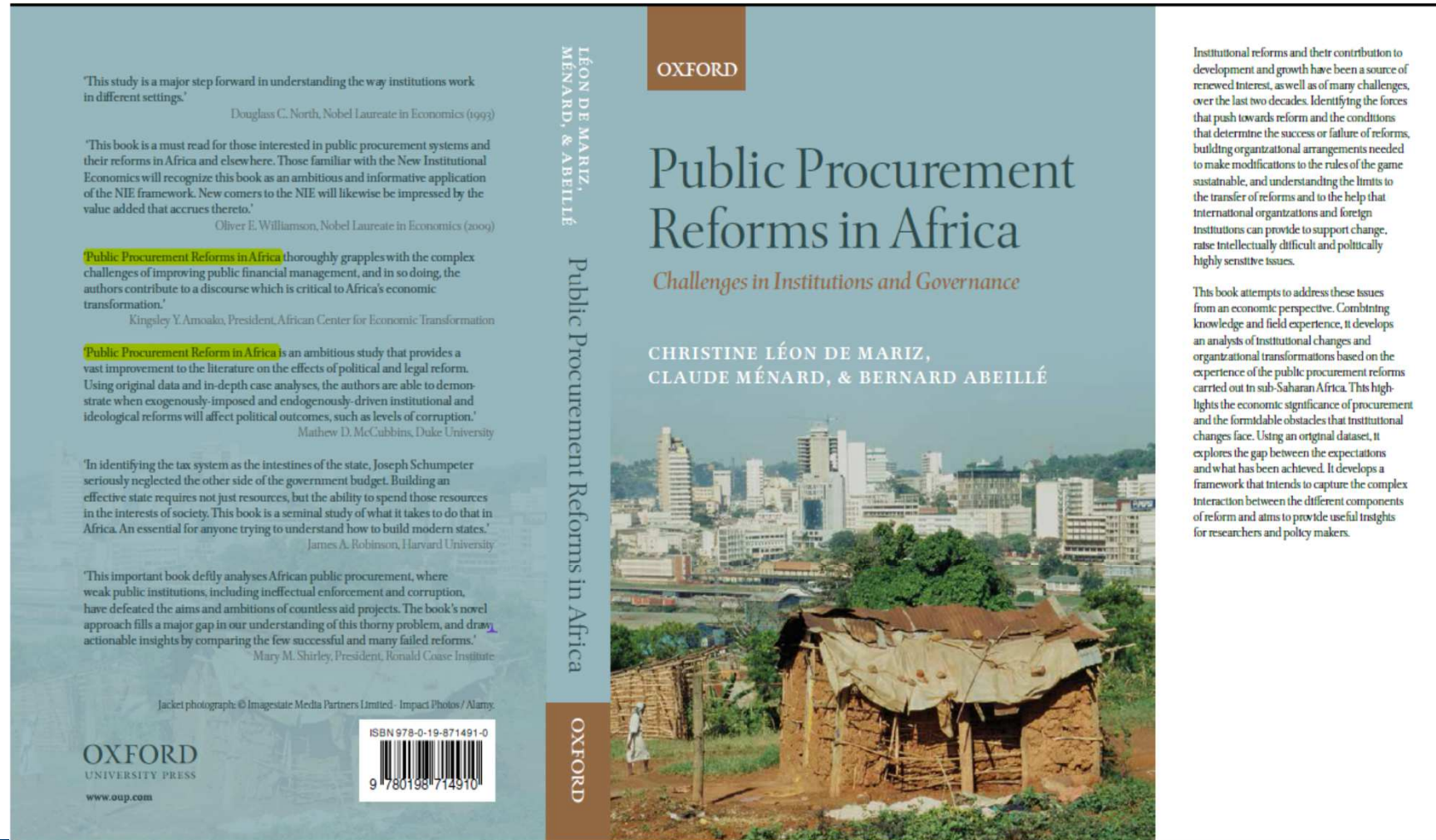
'Independent' regulator as a myth and ... a plague! ?

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MAIN LESSON

- > **WE SHOULD NOT FOCUS EXCLUSIVELY ON THE BIG PICTURE** (legal systems etc.), although we must keep it in mind
- > **IF THE DEVIL IS IN THE DETAILS**, then need to look at these 'details' that are **MESO-INSTITUTIONS**

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'This study is a major step forward in understanding the way institutions work in different settings.'

Douglas C. North, Nobel Laureate in Economics (1993)

'This book is a must read for those interested in public procurement systems and their reforms in Africa and elsewhere. Those familiar with the New Institutional Economics will recognize this book as an ambitious and informative application of the NIE framework. New comers to the NIE will likewise be impressed by the value added that accrues thereto.'

Oliver E. Williamson, Nobel Laureate in Economics (2009)

Public Procurement Reforms in Africa thoroughly grapples with the complex challenges of improving public financial management, and in so doing, the authors contribute to a discourse which is critical to Africa's economic transformation.'

Kingsley Y. Amoako, President, African Center for Economic Transformation

Public Procurement Reform in Africa is an ambitious study that provides a vast improvement to the literature on the effects of political and legal reform. Using original data and in-depth case analyses, the authors are able to demonstrate when exogenously-imposed and endogenously-driven institutional and ideological reforms will affect political outcomes, such as levels of corruption.'

Mathew D. McCubbins, Duke University

'In identifying the tax system as the intestines of the state, Joseph Schumpeter seriously neglected the other side of the government budget. Building an effective state requires not just resources, but the ability to spend those resources in the interests of society. This book is a seminal study of what it takes to do that in Africa. An essential for anyone trying to understand how to build modern states.'

James A. Robinson, Harvard University

'This important book deftly analyses African public procurement, where weak public institutions, including ineffectual enforcement and corruption, have defeated the aims and ambitions of countless aid projects. The book's novel approach fills a major gap in our understanding of this thorny problem, and draws actionable insights by comparing the few successful and many failed reforms.'

Mary M. Shirley, President, Ronald Coase Institute

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OXFORD
UNIVERSITY PRESS
www.oup.com

ISBN 978-0-19-871491-0



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LÉON DE MARIZ,
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Public Procurement Reforms in Africa

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Challenges in Institutions and Governance

CHRISTINE LÉON DE MARIZ,
CLAUDE MÉNARD, & BERNARD ABEILLÉ

Institutional reforms and their contribution to development and growth have been a source of renewed interest, as well as of many challenges, over the last two decades. Identifying the forces that push towards reform and the conditions that determine the success or failure of reforms, building organizational arrangements needed to make modifications to the rules of the game sustainable, and understanding the limits to the transfer of reforms and to the help that international organizations and foreign institutions can provide to support change, raise intellectually difficult and politically highly sensitive issues.

This book attempts to address these issues from an economic perspective. Combining knowledge and field experience, it develops an analysis of institutional changes and organizational transformations based on the experience of the public procurement reforms carried out in sub-Saharan Africa. This highlights the economic significance of procurement and the formidable obstacles that institutional changes face. Using an original dataset, it explores the gap between the expectations and what has been achieved. It develops a framework that intends to capture the complex interaction between the different components of reform and aims to provide useful insights for researchers and policy makers.