

PANEL ON FCR

FULL COST RECOVERY: REFORMS IN CHINA

Mike Fortin, Sangay Penjor

Southeast Asia Water Utilities Network
Hanoi, Viet Nam, 7 June 2005

SCOPE

- Institutional transformation to FCR
- Case study – People's Republic of China
- Other international experience
- Link to 3P options

OVERVIEW

BACKGROUND

- A basic social need → heavily subsidized
- Price regulation after 1978 → Low tariffs
- 1990's Government restructuring, cost control

MOTIVATION FOR REFORM

OUTCOME

- Tariff increases less than cost increases
- Chronic under-funding
- Under-investment in assets

MOTIVATION FOR REFORM

GOVERNMENT REACTION

- Market based reforms in urban water supply – tariff guidelines & corporatisation
- Water tariff increases averaging 17% to 25% annually

GOVERNMENT RESPONSE

POLICY FROM SENIOR GOVERNMENT

Senior government policy defines:

- Components of full cost
- Costs recovery methods
- Financial performance standards
- Reporting and regulatory framework

POLICY FRAMEWORK

PRC POLICY: National Guidelines on Water Tariffs, 1998

- Full cost recovery, reasonable profit, water conservation, user equity
- Costs include: all financial costs and profit
- When & how tariffs should be adjusted

POLICY FRAMEWORK

TARIFF APPROVALS IN THE NGWT

- No senior government approval of tariff increases, only local government
- Reporting of tariff adjustments to senior government
- Supervisory audits by senior government

POLICY FRAMEWORK

PRINCIPAL AGENCIES

- Legislator
- Operator
- Owner
- Regulators

INSTITUTIONAL FRAMEWORK

PRC OPERATOR – WATER SUPPLY CO.

Primary responsibility for:

- Service delivery & compliance
- Operates and maintains facilities
- Manages assets
- Administration, planning, management

INSTITUTIONAL FRAMEWORK

PRC OWNER – LOCAL GOVERNMENT

Has ultimate responsibility for service delivery & compliance

- Sets local policy
- Approves capital & operating budgets
- Approves tariff adjustments

INSTITUTIONAL FRAMEWORK

CONFLICTING POLITICAL OBJECTIVES

Local government is owner and financial regulator → conflict between:

Achieving financial sustainability

AND

Appeasing the public with low prices

INSTITUTIONAL FRAMEWORK

RESOLUTION OF THE CONFLICT

Regulatory oversight by senior government:

- In the PRC - monitoring of financial performance & supervisory audits
- Other options
 - maximum allowable debt burdens
 - licensing of operators

INSTITUTIONAL FRAMEWORK

INTERNATIONAL EXPERIENCE

- Local government reform: US, New Zealand
- Water supply sector reform:
 - (1) Privatization and independent regulation in the UK
 - (2) Legislating financial sustainability in Ontario Canada

PUBLIC INVOLVEMENT

ROLE OF THE PUBLIC

Public opposition to tariff adjustments can prevent the achievement of FCR

Strategies to win public support:

- Poverty alleviation measures → affordability
- Anti-corruption policies → public trust
- Information program → public understanding
- public participation → public acceptance

PUBLIC INVOLVEMENT

FCR TARIFFS & THE PRIVATE SECTOR

With effective FCR tariff policies in place:

- Minimize revenue risk
- Prevent excessive profit taking
- Attract private sector partners

3P options are not a substitute for FCR tariff policies

PRIVATE SECTOR INVOLVEMENT