

## **A CASE STUDY OF THE PRIVITIZATION OF PORT VILA**

John Chaniel, UNELCO Vanuatu Ltd. Port Vila, Vanuatu

The object of this presentation is to show how a particular model of a Concession Contract can be; and has been, a successful option for the supply of urban water in a small island country.

The presentation will show the problems faced by the Government before the service was contracted out, it will show how the Government went about selecting a suitable contractor and how it was a 'tailor made' contract to satisfy its particular needs.

The model of concession, which we present, should be an inspiration to those authorities in small island countries, which are facing similar problems to what we have in the past.

I want to share with you today, the process that we went through and the level of success that the Management and Operations contract had and suggest that perhaps, this could be an option for other small island countries in the future.

### **BACKGROUND**

Vanuatu, which had previously been under the rule of a condominium government (French and English) gained its independence in 1980. At that time the urban water service in Port Vila was operated by the Public Works Department and over the years that followed independence, there was a gradual degradation of the water service in the urban centres, due mainly to the fact that previous help from the condominium partners had been drastically reduced.

Some of the fundamental difficulties were:

- ✍✍ The Government was unable to collect sufficient funds to cover operating costs. Although water was metered and water charges were adequate, the level of collection was poor.
- ✍✍ As a consequence, the Department of Public Works had little or no capital to invest, not only in new works, but also in basic day to day operating needs.
- ✍✍ The network was deteriorating along with the quality of service. This was beginning to tell on the tourism and other industry.

Leaders at the time became concerned and started looking for a solution. The water supply in nearby Noumea in New Caledonia was managed by a private operator, the Group Lyonnaise des Eaux at the time, now called the SUEZ Group. The Government drew its inspiration from what was happening there and set itself some objectives:

- ✍✍ To transfer the responsibility of the operations to a private operator
- ✍✍ To improve the quality of service
- ✍✍ To make the service financially autonomous
- ✍✍ To allocate resources previously dedicated to the urban water sector to other sectors.

At the same time, the Government was clear from the outset on some specific conditions such as retaining ownership of the assets.

### **THE FIRST STEPS**

In early 1992, the Government of Vanuatu called on a number of specialized companies to submit offers to 'privatise' the water utility.

In March of that year, a delegation from the then 'LYONNAISE DES EAUX' Group (now the SUEZ Group) from Nouméa arrived in Port Vila to initiate a process which would allow them to make an offer.

The options on the contents of a contract are so varied, as we shall see, that a dialogue between the potential 'Operator' and the 'Government' was the only way to go to ensure that the Government got exactly what it wanted.

## THE AUDIT

A detailed audit of the utility was carried out by the potential operator to collect data on the state of the network, the equipment and parts, the customer base, the water consumption, growth forecast, resources and so forth. In general, all information that would bear on the future operating costs, investments and revenue base.

## THE PROPOSAL

With this information in hand, a technical and financial study was undertaken by the contractor to determine the operating cost, investments and potential revenue from the operation according to the needs of the Government.

The operating costs were evaluated, e.g.:

- ✂✂ Pumping and treatment costs, that is, the recurring operating costs were evaluated (consumption of choice, electricity etc.)
- ✂✂ Personnel costs – the future personnel structure was designed and its costs evaluated
- ✂✂ The cost of overheads
- ✂✂ Investments to initially improve the network to an operable level and to allow the operator to fulfil his future contractual obligations – this was a point of long discussion with the Government since the infrastructure was in a dilapidated state and considerable up front investment was required.
- ✂✂ Investments to
  - ?? Renew
  - ?? Upgrade
  - ?? Extend the network

These are fundamental points in the contract, that the operator would renew parts of the network as they came to an end of their useful life, it was agreed that the operator would upgrade parts of the network as its capacity became insufficient and would carry out some extensions.

The extent to which these points are treated is very much a point of discussion in the 'operator - Government' collaboration and is a determining part in the cost of water, in this tailor made contract.

- ✂✂ Interest on loans, which in itself depends on the level of investment
- ✂✂ Company profits – the new operation by the private sector needs to be profitable, even if only in the long term – this aspect is looked at in all transparency in the negotiations between Operator and Government.

At this stage, the amount of investments to both initially improve the network and for future extensions, as well as interest rates are key issues as they are a major component of the cost and have a significant impact on the selling price of water. These are the very topics that were subject of discussions during the almost two year process.

Resuming, the operator looked at:

## PIE CHART

This is what we called the 'cost and profit' bubble, which had to be matched to, and equivalent 'revenue' bubble.

The Government and the Operator collaborated to define a price structure, based on the projected costs, profits and volumes of sales that would;

- ☞☞ Be affordable to the consumer;
- ☞☞ Allow the operator to fulfil his obligations; and
- ☞☞ Allow the operator to make a reasonable profit.

And all this whilst ensuring that the revenue matched costs and profits and that the political will to favour one or another group of consumer be respected.

For example, the Government may have wished to either

- ☞☞ Apply a lower price for small consumers with small incomes for social reasons

Or

- ☞☞ Apply a lower price for industry to support the economy.

In this case, the Government opted to advantage the very small consumers with limited income and to charge more to the large domestic and industrial consumers. In effect, the very small consumer is subsidised by the large consumers.

## PIE CHART

Discussions between the two parties continued until the two matched, that was the basis of the Contract for the Management and Operation of the Water Supply in Port Vila which was later signed on 23rd December 1993.

## THE CONTRACT

Here I want to give a rapid overview of the contents of the contract which was tailor designed for the needs of Vanuatu, It may help us to imagine how a similar model may fit in 'your' environment..

The model in Vanuatu is a 'Management and Operation Model', the notable points of which are:

- ☞☞ The contract is for a period of 40 years (explain why)#the network remains the property of the State, it is not 'sold out' 9explain why)
- ☞☞ The operator has the responsibility to operate, renew, upgrade, maintain and extend the network within the geographical limits of the concession area and with a predetermined budget for the next 40 years.
- ☞☞ At the end of the contract, the improved network is returned to the State, or a new contract is signed.
- ☞☞ The price of the water is fixed and varies only by the application of a price adjustment formula.
- ☞☞ The performance of the contract is controlled by the Government – there are periodical technical and financial reports from the Operator.
- ☞☞ The Operator is bound to operate and maintain the network and guarantees the quality, quantity, pressure and continuity of service as specified in the contract. Default includes penalties.
- ☞☞ In return, the Operator charges for his services.

## CONCLUSIONS

To draw conclusion from our experience let us look at the performance of the contractor over the past 9 years.

In all we see that

- ✍✍ The conditions of the contract were tailor made to suit the needs of the Government of Vanuatu through a long dialogue between the Operator and the Government – there were no ‘surprises’ for either party and the Contractor has fulfilled his obligations.

Urban Port Vila has been made accountable and self-sufficient at an affordable price for the consumer. The Government no longer loses money on the utility and can now allocate resources to other sectors such as rural water supply.

We have found that the public who was previously reluctant to pay for the service because it considered it inadequate, is now satisfied and collected revenue reaches almost 100% of the invoices.

The moral of this experience to us, is that ‘to each his own profession’.

Operation by a private operator can be and has been a success.

By making sure that our ‘specific’ requirements were catered for in the contract, we managed to satisfy our needs and those of the operator, issues such as

- ✍✍ Ownership
- ✍✍ Scope of works
- ✍✍ Affordability
- ✍✍ Etc.

If anything, because of the financial constraints emerging from the ‘cost’ bubble and the ‘revenue’ bubble analysis, and the notion of affordable price, capacity for investment in new extensions is limited and there is indeed potential for outside funding to extend the network outside of the concession area.

We are addressed successfully and we urge other small island nations to consider this option.

How can this be a model for others.