

**USAID ECONOMIC GROWTH OFFICERS CONFERENCE
OCTOBER 15-19, 2007
WASHINGTON, D.C.**

Session Title: Infrastructure and Sustainability – Use of Operating Contracts in Post-Conflict Situations

Date and Time: October 16, 2007, 1:00-2:30 p.m.

Type of Session: Plenary

Speaker(s): Bob Ichord, USAID and Allen Eisendrath, USAID

Moderator: David Dod

Overview of Session:

The first half of Allen Eisendrath's discussion emphasized the importance of rapid infrastructure restoration and elaborated on some of the problems or misconceptions that occur. The second half looked at Operating Contracts and their success in Uganda. Bob Ichord spoke in more detail on the key characteristics and challenges of infrastructure projects.

Speaker's Remarks: Allen Eisendrath

Providing basic water, electricity, and transport services is critical to government credibility. Investment is important, but frequently there is a cycle of physical and commercial decline. Informal privatization often occurs through employees, government officials and local mafias, which makes sustainability a challenge. In times of stress, corporate governance may deteriorate, and asset stripping often increases. There is a tendency to concentrate on physical facilities, although private ownership or concessions may be best long-term solution.

In most cases, rebuilding infrastructure and turning it over to local public authorities is not enough to ensure improved services. Newly rehabilitated facilities may not be properly operated or managed and will fail over a relatively short period of time. There is not always caused by problems with the physical infrastructure. Root causes include rampant corruption, weak governance, and bad management.

USAID conducted a review of 11 infrastructure projects among donors to assess problems and solutions with operating contracts:

- 1) management – management responsibility
- 2) concession – full responsibility & investments
- 3) affermage/lease – operator has full operational and commercial control; public sector provides capital.

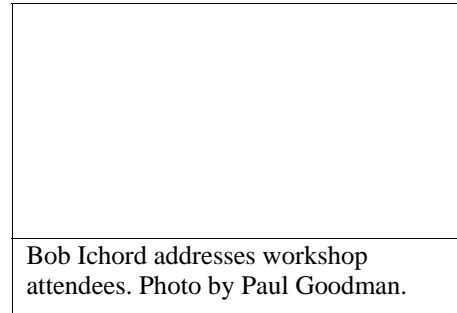
When Uganda experienced a decline in infrastructure, they established 57 operating contracts and delegated as “Areas Management Contractor” the National Water and Sewage Corporation. Huge gains were made in six years. The NWSC now has 140% coverage of operating & management costs and non-revenue water was cut in half. What they discovered was that local operators can do the job, and will bid if it is properly designed. For example, incentives must be right, and the progression for incentives must be short in the beginning.

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The basic conclusions are as follows: operating contracts can turn around infrastructure decline and they work well in post-conflict areas. Although they must be tailored to specific political and economic conditions, they are effective first steps to commercializing a deeply troubled utility. Currently, USAID is supporting the development of operating contracts in Uganda, Montenegro & Georgia, Afghanistan, Yerevan, and India in Orissa.

Speaker's Remarks: Bob Ichord

When looking at energy systems, one must take an overall approach to energy in the context of economic growth. For this reason, Mr. Ichord prefers the term “energy systems” to “infrastructure.” Institutional, regulatory, social and political aspects are as important as pipes and wires, and this is USAID’s competitive advantage.



Energy systems play an important role in modern economies and the production function. It will be an increasingly important issue over the next decades as there is a linkage between energy and environment and economic growth and employment. Many countries are facing severe problems in energy, some of which are tied to the environment (e.g. the Balkans). USAID has tried to link energy to economic growth and to the broader issues of poverty, stability and governance. They tried to do this on regional basis with Energy Security Goals that linked with the missions’ strategic objectives. This regional/global linkage with the mission’s approach has tremendous potential in creating efficiencies that can free up funds for other critical investments.

USAID must help to improve customer service to support economic growth. There are three key aspects within the electric system framework:

- 1) Affordability: achieved through competition, economic efficiency, and social responsibility
- 2) Reliability: achieved through the security of supply, technical efficiency, and environmental sustainability
- 3) Transparency: achieved through improvements of corporate governance, accountability, and regulatory effectiveness

There are six broad diagnostic issues that must be examined when designing programs:

- 1) Broad view of key actors and their political positions in the system
- 2) Geographical characteristics
- 3) Conflict, quality of services, and technical losses to system
- 4) Cost recovery and financial systems
- 5) Regulatory environment; and
- 6) Access of communities to service.

On a smaller scale, one must also navigate the political minefields, which can include central and local tensions, ethnic conflict, corruption in management and collections, inter-ministerial issues, and donor coordination issues.

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When confronting institutional and managerial weaknesses, there are a series of questions to be answered:

- 1) Are basic institutions in place?
- 2) Is there differential among policy, regulatory, and operation functions?
- 3) Are there committed leaders to work with?
- 4) What kind of team building is possible?
- 5) Is training of local staff and companies feasible?
- 6) How easy is it to hire and fire workers?

Political support and competence of people are key conditions for success of management and operating contracts, and there must also be a road map. However, Mr. Ichord is a fan of strategic distribution privatizations and states that management contracts should be last resorts

He concluded by reiterating that policy regulatory issues are critical and applicable to post-conflict situations and emphasized three rules:

1. There is no such thing as a free lunch – everyone must pay.
2. Must develop local capacity – not everything can be solved by donor financing
3. Pay now or pay later

Key Points Discussed During Question & Answer Segment:

Q: The success in Uganda with water districts is impressive. However, unbundling in electricity is usually done with distribution and production, not geographically, which precludes small towns. Is anyone thinking in these terms? Is there anyway to have partial unbundling, or multiple tiers? Perhaps secondary towns unbundled geographically?

A: Most clients are big companies, but some clients are in less densely populated areas. When the government initiated output based assistance, they let the market work. In Guatemala, the government did not prescribe how it would be done, and it resulted in 2 levels (3 large-scale and 17 small-scale).

A: Two cases have examples of geographically carved areas where it is working. There are a lot of advocates for decentralized small-scale, town-based systems.

Q: From a competitive standpoint, projects take full advantage of reform. What are your views on this and how can we improve dialogue in AID on integrating these issues into more mission level programs?

A: Juan: Most assume infrastructure is too expensive, but they paid less than \$100,000 to reform Guatemala. Very small investments in regulatory framework can have tremendous impact. This could not have been achieved by direct support through establishing cooperatives. It was achieved by bringing in private sector and bringing in money from privatization. We are trying to pass the message that infrastructure is not simply bricks and mortar, it also includes regulatory reform.

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A: Many surveys have shown that businesses are concerned about unreliable and low-quality energy. There needs to be recognition that these problems are serious constraints to growth. They especially affect the small business sector. Another competitiveness issue is that some opportunities relate to information technologies and similar areas where new small businesses can develop, but energy quality is very important for high tech companies as well.

Q: What have you run into in the way of non-performing liabilities and unpaid bills – what have been the strategies and lessons?

A: I support trying to get private management. One can cut off the government's energy connections. Clearly, budgetary organizations and water companies tend to be the largest non-payers. We need to go to others in the government to illustrate the need for more fiscal discipline. Ukraine created line-item budgets that would allow for transparency.

A: There should be an accounting of whom owes what and to whom (this was done in Honduras and Nicaragua). Currently, there is an attempt to work with the World Bank on study of losses to determine how much was billed and how much was injected into the utility grid.

Q: Are we doing enough on infrastructure early on in post-conflict period?

A: There may be too much of the wrong things done early on. There must be a balance.