

# **Water Privatization in Developing Countries: Case of Albania**

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## **Abstract**

A safe, clean, accessible and affordable drinking water and sanitation service for all individuals is a human right recognized explicitly from the United Nations General Assembly (Resolution 64/292, July 2010). Access to clean drinking water is so crucial for development that developed countries have made significant investments in water infrastructure (production, distribution investments in investments in piping, pumps, water purification systems and wastewater treatment plants etc.), managerial structures and capacities.

The picture is very different in developing countries. One of the main problems is the lack of efficiency of the water systems, leading to a higher loss rate (from system leakage and illegal connections to the system) and cost-recovery failure because of the low revenues from tap water sales. In most of the cases governments fail to finance the financial loss of the water suppliers and in this way fail to fulfill the public need for drinking water and sanitation and water treatment services. So an alternative to solve the situation is seen the privatization of drinking water sector.

The paper will give a summarized picture of the phenomenon in the world having as the case study the situation in Albania during years starting from the legislative frame, previous attempts to future tendencies related to the privatization of drinking water sector. The main objective is to explore the arguments pros and cons related to the privatization of “an economic good” such as water suggesting different alternatives in this context.

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**Keywords:** Water sector, privatization, financing, human rights

## **Introduction**

Providing clean, safe and affordable drinking water and sanitation and water treatment services is extremely costly in developing countries. If developed countries have invested a lot in this sector, in the developing countries the situation is in reverse.

Privatization of public water sector has emerged as a possible alternative. There are some pros and cons. Private sector participation in water sector (a public sector), is seen as a solution since private agencies are better equipped to deliver clean and safe water and sanitation services to the public compared with government bureaucracies and lack of financing losses of the sector. From the other hand many others think that this is a source of pure business opportunities and to do this with a public good as drinking water is risky enough.

Since the late 1980s, the main objective of different financial institution (international ones!), or donors from different development agencies was public infrastructure privatization. The tendency started with electricity and telecommunication sector but water sector is not fully explored in this aspect. It's a wrong perception that investments in this sector are risky and not stable. For the case of Albania, there are a few empirical studies of the sector to support any real incentive for privatization even that a few incentives are made.

The main objective is to explore the arguments pros and cons related to the privatization of “an economic good” such as water suggesting different alternatives in this context. The paper will review the literature on impact of privatization of the water sector in section 2. The section 3 will review the case of privatization in Albanian water sector from the first incentives in the sector from 2002 and on. The last section will conclude and suggest some alternative solutions for the case of developing economies.

### **Literature review**

There are different empirical and theoretical works about the impact of privatization of firms and sectors and specifically of the water sector.

One known work was Megginson et al. (1994) that examined a set of 61 companies for the period 1961 and 1989. He proved that a decrease in leverage lead to an increase in the median level of employment. This was a micro firm-level data that didn't ensure explanation for particular sector such as water supply.

Boubakri and Cosset (1998) studied 21 developing countries between 1980 and 1992 (with a sample of 79 companies) and measured statically significant increases in output (real sales) after privatization. The increase was documented also in profitability and capital investment. They repeated the study later on 2002 for 16 African companies between 1989 and 1996.

Bayliss (2002) has seen the complex part of the privatization process and argues in favor of case-by-case studies. There are studies focusing on the water sector such as case studies or pure empirical works. These last ones have a result in common: privatization increases economic performance;

meanwhile the works based on case studies documented not a overall benefit from the process.

Alcazar, et al. (2000) studied concession contracts in Buenos Aires for the water sector documenting an increase in investment more than 2 times, higher coverage with service and improved quality of services.

Galiani (2005) studied in Argentina the link between infant mortality rate and water privatization during the period 1991-2000 (on this period was privatized one third of the Argentinean water providers). The results were impressive: the infant mortality rate dropped from 5-24% and also there was an increase in investment and efficiency of the sector.

Estache et al. (2001) were concerned that privatization process (including the consequences such as an increase in prices or investment level) may affect only the poorest individuals; private providers may forget to include also marginal effects in the decision making. So, for the poor part of the society the increase in efficiency of the sector due to privatization will come at the cost of the quality of their life.

For the situation in Albania there are no similar empirical works of water reform impact.

## **Albanian water sector privatization**

### **An overview**

The lack of internal investment in Albanian water sector from 1970s, leads to an old and amortized production and distribution water system unable to fulfill the increasing need of population for drinking water and sanitation services. From the period after World War II up to the fall of communism regime in 1991, the water sector was administrated by the Ministry of Construction for the main issues such as tariffs, collection of bills, investments etc. Since tariffs were low artificially, this meant from one hand lower revenues from collected bills and not coverage of operating costs for providers and from the other hand this increased wasted water from consumers (World Bank 2003).

From the history is known that the first limited water network in Albania was constructed by Italian companies in 1930. From 1950-1978 there was an improvement and development in the sector with the funds by socialist European countries and China. From 1978-1991, the period of isolation led to lack of funds in the sector and massive deterioration of water supply infrastructure. Again low water tariffs lead to massive water waste from consumer and commercial sector. After the fall of communism regime up to 2003 is known as a start period of water reform in Albania. The open economy led to more international financial aid (World Bank 2003).

The support from World Bank dedicated to water sector started from 1994s in the form of private sector partnerships (PSPs). The first project was

implemented in the city of Durrës ensuring local government support and rehabilitation investment in the system. The project was closed in 2000. The next project provided funds for improving the water system in regions of Fier, Lezhe, and Sarandë city from which benefited around 140,000 inhabitants. The year 2004 is the one of implementing pilot projects PSPs (World Bank, 2005).

In Albania water sector there are two form of private – public partnership: concession and management contract form. One concession contract in 2002 was awarded from Berlin Wasser international company, supported by KfW Bankengruppe to the Elbasan city water provider and expired after two years. A management contract was signed in 2003 awarded to AquaMundo in the Kavaja city and many others awarded from World Bank in four more different cities. From 2008 and on there is no presence of private sector in the water and sanitation sector in Albania (Zeneli F. 2017).

### **Pros and cons about water sector privatization:**

With the increasing rate of population and the amortization rate of water infrastructure, suggesting privatization is convenient for the government. A private partnership in the water sector will bring new funds for financing development of water production and treatment plants, or increasing efficiency and quality of water supply. These benefits are in macro level and maybe not very convenient for the corporate and its financial situation. This situation can lead to decisions not in synchrony with public interest and provision of drinking water (considered a public good).

Another aspect related to the privatization is the nature of water sector very different from telecommunications or electricity sectors where a tendency for privatization is common. A higher required capital for infrastructure investment puts the corporate in a monopoly position: there is no real competition between piped water systems.

Also, the water sector doesn't follow the normal laws of market. The demand for the mentioned services is inelastic to the price (since drinking water is a necessity good); the prices come in the form of tariffs set by governments (not based on supply and demand).

There is a risk that poor people will not get access from water systems because of the tariffs that are increasing for the sake of recovering the operational costs of water providers. The World Bank states that in the developing countries there are not enough funds to minimize the gap between different economical categories of population in terms of water supply. It's believed that privatization can boost efficiency if two conditions are fulfilled:

1. Investment projects in water infrastructure or management activities should generate revenues to completely cover operational and maintenance costs;

2. If there are risks, they should be identified and delegated to the party that can deal with them.

There are some international institutions that can play the role of intermediaries for water privatization formulation and design contracts. World Bank is one of these, acting as an international lender for different contracts in the utilities sectors.

Also the partnership contracts between private and public sector should be formulated not only in the perspective of a choice taking but also on the lens of contract/private ordering that produce implications and have public-policy lessons that go beyond industrial organization (Avinash, 1996).

There is a wide literature that it's related with the importance of government level of credibility and the effects of regulatory frameworks on private participation in provision water services that are public managed. The relation between both of them on the managing of publicly owned water system reflects also the incentive problems such as low coverage, limited investment, and poor quality service (Savedoff and Spiller, 1999).

The ways how the two entities react to regulatory frameworks or/and incentive structures are different: while private companies use them to maximize the return minimizing the risk, public entities (that do not ensure direct profit from asset ownership) can dissipate rents through different inefficient forms of resource usage (i.e. excessive employment). So there is room for governmental opportunism and if this one could be minimized, the public ownership will be limited in providing services in the water sector.

In the figure 1, is shown the downward spiral of low prices (so low that they fail to provide the operator -public or private – with the ability to finance its business expansion) (Savedoff and Spiller, 1999). This brings a stable equilibrium even with low prices and low quality.

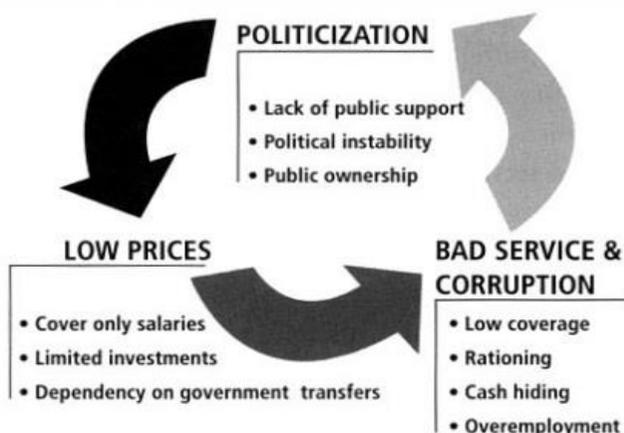


Figure 1: The downward spiral of low prices  
Source: Savedoff and Spiller (1999)

In the above equilibrium the prices are low, also the coverage rate and quality is low including the limitation of government transfers. But it seems that no agent (the government, the consumers or private entities) want to change the achieved position. There are three main reasons that this equilibrium is stable: (i) no motivation for increasing prices to cover operating costs, (ii) lack of governmental expenses for a bad-managed entity and (iii) unless there are some basic changes in institutional level, every tendency to improve management will fail.

How to move from these equilibriums? First of all this is a governmental obligation. The initial thing recommended from international agencies is that prices should cover operating, maintenance and investment costs. This reform should be done together with improvement of services because otherwise will have social costs. Second there are the so-called performance contracts signed between government and management board in exchange of a profit portion. For increasing the performance of public sector these contracts have failed (Shirley and Xu, 1996). The reason beyond this is the asymmetry of information between the two agents. Third, what it's suggested is the decentralization of the service provider even with no significant impact in improving quality in Latin America. Finally, what literature suggests is the implementation of BTO-s contracts that add capacity with no fundamental changes in management and any direct transfer from the government required this in context of no effects on the political interests. Because of the government credibility issue these contracts are wrongly perceived as expensive.

There is no a right, unique model designed for the privatization of water and sanitation facilities: there are concession contracts or management ones, assigning completely commercial risk to the operator or not. Also will more productive to look for policies and implications that solve the situation rather than to discuss about the importance of access to water as a human and natural right. One alternative suggested by the recent literature to Public Private Partnerships is public finance. As a concept is new implemented that allows governments to improve water and sanitation infrastructure using public finance for investment. From the other hand private corporate are able to deliver the service with more flexibility, higher control and efficiency. And they can be repaid back in the long term, due to user charges (tariffs). This practice could also help with the unemployment issue (Zeneli F. 2017).

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## **Conclusion**

If we speak theoretically the process of privatization seems a convenient economical opportunity to finance domestic water supply and sanitation infrastructure. There are some successful private-partnership in this sector and some failed ones as well.

The process itself is very sensitive and should be designed taking in account the specifics (economic, political and cultural) of the operational environment. Also it should be relevant to take in account that in developed economies, citizens are used to pay the right and real cost of the water, so an increase in tariffs because of the presence of private sector in the water infrastructure will raise their awareness for conserve water. Meanwhile in developing countries people are high sensitive to higher water tariffs and this fact can increase the risk of poorest people not to have access in drinking water systems.

If there is settled a partnership between private corporates and governments on the water sector, for it to be successful it should be reciprocally beneficent with unique suitable contracts, with policies of differential tariffs for poor areas, free quotas for basic requirements that can recover the costs, a contract that should identify risks ahead of time to be able to overcome unexpected obstacles effectively.

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