

Water supply and energy services for the poor: Rules make markets

THE PROPOSITION

Deregulation and privatization in the water supply and energy sectors, as a means to stimulate private-sector investment have been widely advocated but have only led to improved services for the poor when effective regulation mechanisms have been put in place by governments and public agencies. Privatization without clear rules of the game has often led to fewer and worse services for poor households and poor areas as investors, national and international, face higher perceived risks. Market mechanisms and private-sector investment will not adequately address the water and energy needs of poor people, nor address environmental externalities, unless specific public policies and regulations are put in place to direct the market. This is an essential role for government that must be part of the re-regulation process. This also provides the clear signals, institutional roles and revenue management rules that investors require in order to be attracted to these markets. Strong regulatory agencies are needed to make markets work and address social and environmental objectives. UNDP believes that capacity-building in policy and institutional approaches to achieve this are widely needed.

THE CONTEXT

Historically, the public sector financed the majority of investments for water and energy services. Additional resources from private-sector sources and capital markets are essential to generate and distribute electricity and to provide water and sanitation services owing to constraints on national budgets and official development assistance. This will only occur if the regulatory frameworks, public policies and rules of the game are clearly defined by government entities and independent water and energy regulatory agencies. Direct foreign investment has been uneven across developing countries. As a general principle, it is not sustainable to subsidize water and energy consumption through artificially low tariffs for all categories of consumers. Subsidizing access for poor households (appliances, connections, meters, etc.) is a good use of public resources as a means to achieve social objectives and poverty reduction. Other approaches including progressive tariffs for different end uses, flat-rate payments for low-volume consumers, consumer credit to level and finance payments, and pre-paid mechanisms for household water and electricity supply, are all effective means to target poor households, improve affordability and expand access to services.

Greatly increased access to energy services, those derived from electricity or cleaner fuels, and access to clean water for household and productive uses are essential to reduce poverty and reach many of the MDGs. Water and energy are critical to improve agriculture, support industrial activities, enhance education, create jobs, reduce drudgery for women and meet the daily cooking, nutrition and health needs of families. Currently 2 billion people lack access to electricity, 2 billion rely on traditional fuels for cooking and heating, 1.1 billion do not have clean water, and 2.4 billion have no access to basic sanitation. Delivering affordable and reliable water and energy services to poor families, therefore, must be a priority on the development agenda. Private-sector and market-based incentives are not adequate to address the full range of water and energy considerations linked to poverty reduction goals. This is particularly true in rural areas where the majority of poor people live, and in urban slums, which are rapidly growing in all regions of the world. (For more information, read the UNDP and [Water Introduction page](#) and ["Water Governance for Poverty Reduction"](#)).

THE EVIDENCE

UNDP's position is based on [experiences in water and energy utility privatization, especially in Latin America and Asia](#). When privatization took place in advance of establishing regulatory frameworks, overall service provision, especially for poor households and communities, deteriorated. [Country evidence in Argentina and Chile](#) shows that rural areas connected to electricity grids are sometimes economically unattractive to private-sector investors seeking high returns through increased tariffs and sales volumes that are only possible in urban, industrialized or highly populated areas. The ["World Energy Assessment" 2000](#) and ["Energy for Sustainable Development: A Policy Action Agenda" UNDP, 2002](#) trace global experiences in energy and energy policy. [In the case of water, large industrial users rather than households are often preferred customers](#), as seen in many Asian countries. Citing lack of profits, many private investors have in fact withdrawn from water, sanitation and energy supply. A strong government role mandating expanded access to services for poor people and communities is recommended based on the evidence. Rules are essential to make markets work for both business and the poor. Other resources: ["Energy for the Poor", DFID](#); ["Energy for Tomorrow's World"](#) and other [World Energy Council publications](#); and the ["Water Policy Journal"](#). Extensive community level experience in water and energy is available from the [GEF Small Grants Programme reviews](#).