

## Monitoring MWSS- Water Rates

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The management of Manila's water and sewerage distribution system (MWSS) was privatized in August 1997 in what has largely been touted as a 'successful' water privatization, and the largest to date in the Asia-Pacific region. The International Finance Corporation (IFC), the World Bank's private sector arm, was adviser<sup>1</sup> to the privatization, which resulted in two 25-year concessions (east and west) competitively bid.<sup>2</sup> Bidding was based on the lowest average tariff to cover operations, investments and profit. All bids came in below the prevailing tariff of PhP8.78/m<sup>3</sup> (\$0.00/m<sup>3</sup>). The winning bids were Benpres/Suez-Lyonnaise (Maynilad Water Services or MWS) for the west at PhP4.97/m<sup>3</sup> (\$0.12/m<sup>3</sup>) and Ayala/Bechtel/Northwest (Manila Water Company or MWC) for the East at PhP2.32/m<sup>3</sup> (\$0.06/m<sup>3</sup>). Under separate concession agreements, Maynilad and MWC have 25 years to rehabilitate and operate the water system, reduce physical losses, check illegal usage and expand service coverage.

From the onset, civil society groups have challenged this so-called success due to the non-democratic and non-transparent nature of the privatization process, the lack of a 'full-options approach', and massive job displacement which ensued. In recent years, protests have greeted regular water rate increases sought by the two private concessionaires. These water rate hikes will only bring added burden, especially to urban poor households and the women who manage these households and who are still struggling to keep pace with the aftermath of the 1997 Asian crisis and expected global recession following the September 11 attacks in the US.

The 'privatization' of water is a consequence of the now prevailing view that water is an economic good rather than merely a social good. This is contrary to the long-held notion of water as a free natural resource on which whole cultures and livelihoods of rural and

indigenous communities are based. International financial institutions like the World Bank, International Monetary Fund and Asian Development Bank have been primarily responsible for this new paradigm, which also now looks at water as a tradable commodity. Regimes of 'tradable water rights' and 'water uses of higher value' in the near future will sell water to the highest bidder, and poorer men and women will no longer be able to compete.

### Where does ADB fit in?

The ADB has played a leading role in the development of the country's water supply and sanitation sector since 1973, financing 13 water supply projects and a sewerage project and 13 technical assistance grants. Over the past ten years, the ADB has poured several loans amounting to roughly \$426 million to improve the water supply and distribution of the MWSS; to other water districts nationwide, ADB poured in a total of \$131 million.<sup>3</sup>

In September 1999, the ADB approved a \$170 million loan to Maynilad Water to improve and expand water distribution and wastewater treatment services. This is the Bank's first assistance to a privatized water and sewerage utility. Maynilad has assumed implementation of two ADB-funded MWSS projects – (a) \$130 million Angat Water Supply Optimization project and (b) \$31 million Manila South Water Distribution project -- to increase water supply, with a new water source expected from the \$92-million Umiray-Angat Transbasin, another ADB-funded project.

The ADB private sector loan to Maynilad is part of a \$350 million debt package being raised by the water firm to meet its financing needs up to the year 2002. Other ADB co-financiers include the European Investment Bank and a syndicate of international commercial banks. Equity financing of \$135 million supposedly will

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be provided by Maynilad's sponsors -- i.e., Benpres Holdings Corporation of the Philippines, Suez-Lyonnaise and Lyonnaise Asia Ltd. of Singapore. In other words, at least half of the financing requirements needed by the MWSS private concessionaires was raised from inter-governmental public funds (ADB) in what may be a case of the private 'crowding out' the public.

A \$0.6 million Technical Assistance (TA), 'Capacity Building for the MWSS Regulatory Office', is in the pipeline. Another \$0.15 million TA is also in the offing on Laiban Dam to augment water supply, which may be as big as the controversial San Roque Dam and implemented through BOT; funding required is initially estimated at \$1 billion. Moreover, two other TAs on (Small Towns) Water Supply and Sanitation are in the pipeline.

### What happened to water rates?

Grounds for rate increase. Water rates can be adjusted in three ways: (i) based on the consumer price index (ii) extra-ordinary price adjustment (EPA) for the financial consequences of unforeseen events beyond control of the concessionaire and (iii) rate re-basing adjustment (every five years).

- There are 11 grounds for EPA in the Concession Agreements; these include inflation (to be determined by the consumer price index), foreign currency fluctuations of

more than 2%, and force majeure such as El Nino.

- The first rate re-basing may take place either in 2003 or 2008, largely on the discretion of the MWSS Regulatory Office (RO). Water rates will then be set at a level that will permit the concessionaires to recover, over the 25 year term of the concession, all operating, maintenance and investment expenditures prudently and efficiently incurred. The rates of return on these expenditures for the remaining term shall be in line with rates of return being allowed from time to time operators of long standing infrastructure concession agreements in other countries having a credit standing similar to that of the Philippines.

Annual water rates. Table 1 shows the increase in water tariffs (basic charge) since 1997. The two private concessionaires filed its first petition for rate increase barely a year after privatization, citing 'extraordinary circumstances'. Vigilance on the part of citizens' groups, however, ensured that the amount of water rate hikes sought by Maynilad and Manila Water were not granted by the MWSS RO. The EPA component in annual rate increases had only been an insignificant percentage (2-6%) of the total tariff increase granted. (See Attachments A and B for rebuttal statements submitted by oppositors – e.g., ordinary consumers, Freedom from Debt Coalition.)

**Table 1. Average tariff rate (PhP/m<sup>3</sup>).**

	MAYNILAD	MANILA WATER
Pre-privatization 1997-1998		PhP 8.78
1999	PhP 4.96	PhP 2.32
2000	PhP 5.80	PhP 2.61
2001	PhP 6.13	PhP 2.76
	PhP 6.58	PhP 2.95

(Source: MWSS Regulatory Office, 2001)

Aside from the basic charge, other fees are also collected in the monthly water bills – a fixed cost of PhP1/m<sup>3</sup> of water consumed for currency exchange rate adjustment (CERA), environmental and sewerage charges, and miscellaneous fees. Today, a household consuming an average 30 m<sup>3</sup> of water per month in the west zone (Maynilad concession) pays PhP15.54/m<sup>3</sup>, or PhP466.20.

1998: Rate dispute between MWSS RO and Manila Water. . In 1998, a major dispute has arisen between Manila Water and the MWSS over tariffs. The concessionaire sought a PhP2.23/m<sup>3</sup> increase in its tariff over a period of

four years and P0.97/m<sup>3</sup> for the next 20 years; this is equivalent to a PhP2.06/m<sup>3</sup> increase for the whole concession period. The MWSS granted only PhP0.04/m<sup>3</sup> or a mere 6% of the increase sought. Manila Water sought international arbitration<sup>4</sup> in September 1998 which promptly ruled in favor of the private concessionaire. The MWSS appealed this ruling at the Philippine Court of Appeals; by some mysterious twist of events, this appeal was recently withdrawn.

The MWSS-Manila Water dispute is related to the so-called 'appropriate discount rate' or ADR which the MWSS had set at a constant

5.2% for Manila Water, based on the concessionaires' 1997 financial model and bidding assumptions. (ADR for Maynilad was 10.4%.) In May 1998, Manila Water claimed a market-based ADR of 18% which the MWSS RO did not allow. Had Manila Water used the 18% ADR in 1997, it would not have won the bid. Now that MWSS withdrew its appeal, a major consequence would be the retroactive increase (to 1998) in water rates, and significant rate increases to be granted to Manila Water in future.

2000-01: 'Accelerated' EPA sought by Maynilad. Last year, Maynilad filed a petition for an 'automatic currency exchange rate adjustment' (autoCERA) and consequent rate increase of PhP4.75/m<sup>3</sup>. This increase in water rate will allow Maynilad to recover some PhP2.7 billion (\$52 million) of foreign exchange losses due to peso devaluation covering the period August 1997 to end-December 2000. (Maynilad absorbed 90% of MWSS' foreign-denominated loans.) Maynilad claims to be experiencing these huge losses and severe liquidity and bankability problems as a result of the Asian crisis and the more recent impeachment trial. Since March 2001, Maynilad halted its monthly concession payments of PhP200 million to MWSS, in what is tantamount to a situation holding the MWSS hostage to ensure that Maynilad's petition is acted on favorably.

An overzealous MWSS Chief Regulator (now resigned, and amidst allegations of bribery) ensured the signing of a so-called Memorandum of Cooperation (MoC) between Maynilad and the MWSS in June 2001. The MoC would allow Maynilad to: (a) accelerate the recovery of its foreign exchange losses and subsequently impose a rate increase amounting to P4.75; (b) scale down Maynilad's performance targets, and (c) lower the billed volume from the levels in Maynilad's financial model (on which basis it won the bid for the west zone), to actual levels.<sup>5</sup>

What the MoC approved in effect was an 'accelerated' EPA and the deferment by Maynilad of its service obligations (e.g., almost 100% coverage by 2006, which should also include urban poor households; decrease in 'non-revenue water'; sewerage/sanitation services). In effect, the MoC is a case of *'dagdag presyo, bawas serbisyo'* (or, increased prices for less services). The 'accelerated EPA' under the MoC will allow Maynilad to recover 95% of its foreign exchange losses upfront (within 18 months), and 5% over the remaining life of the 25-year concession.

Civil society groups have again raised strong protests over the legality of the MoC, citing that the MoC has violated the original concession

agreement and undermined the integrity of the 1997 bidding process.<sup>6</sup> Maynilad's huge losses are a result of its inefficiency and mismanagement.<sup>7</sup> Hence, government should not allow the rate increase which bails out the water firm and passes on the costs to consumers, especially to women in customer-households who have to manage tighter budgets also as a result of the same peso devaluation. Due to the strong opposition, Philippine President Gloria Macapagal-Arroyo ordered that the MoC be reviewed.

The most recent news, however, is that Maynilad will finally be getting the increase it has sought. It will also be allowed to implement a so-called foreign currency differential adjustment (FCDA) – the same banana as an autoCERA but termed differently. Thus, Maynilad will be allowed to recover 95% of its forex losses (for August 1997-December 2000) upfront within the next 18 months. Thus, the same household consuming 30 m<sup>3</sup> of water monthly in the west zone will now be paying PhP592.50 from the previous PhP466.20, or an increase of 64%.

Manila Water also filed its own petition for rate increase, at P1.24/m<sup>3</sup>, and has now demanded 'equal treatment' as the Maynilad.

More rounds of increases. In the near future, at least two instances of rate increases are foreseeable:

1. In January 2002, consumers may again be confronted with another rate increase due to EPA – this time from grounds aside from foreign exchange. Both private concessionaires have already griped and petitioned for increases in 2002 due to 'cost over-runs' which they claim are a result of government delay in the completion of the Umiray-Angat Transbasin project which augments the water supply in Metro Manila. The fact that both concessionaires have not completed their own obligations re laying down additional pipelines and addressing losses due to non-revenue water anyway lends little credence to this claim, however.
2. Since the stage has already been set, a rate re-basing is likely to occur sooner (in 2003) rather than later (2008). This would mean another round of increase and more protests.

### **Co-privatization – An alternative to water rate hike**

All through the period of its appeal for water

rate hike, Maynilad -- through its giant media conglomerate -- has appealed to the Filipino public's emotions in portraying the choices only between having water and no water at all. To counter Maynilad's water rate increase, an alternative and win-win 'co-privatization' solution was set forth by the Freedom from Debt Coalition (FDC) in September 2001, with endorsements from many Philippine-based groups.

Co-privatization would enable consumers to buy into Maynilad and participate in its ownership -- 'Instead of simply paying more for a water rates increase without getting anything in return, consumers would develop their stake in Maynilad and eventually benefit from it not only as consumers but also as owners.'

Co-privatization is also an alternative way of generating cash from consumers that is at the same time long-term capital, based on the principle of simply charging them a price that they can bear and afford. Through co-privatization, Maynilad's capital position would be beefed up enough to improve its creditworthiness and thereby enable Maynilad to procure medium to long term loans for its capital expenditures. Co-privatization would strengthen Maynilad's accountability to consumers cum part-owners of the privately-managed enterprise.

In addition, there are clear macroeconomic benefits of a large-scale application of co-privatization, as follows -- Development of capital markets, with the introduction of new debt instruments and the emergence of a mass base of investors; Creation of a base of forced savings as millions of consumers regularly and reliably plunk equity on the basis of their consumption; Emergence of management discipline tools to check institutional management and investors (failure to perform efficiently and effectively results in dilution of their position and control); Real possibility of a diminished fiscal burden with greater consumer accountability.

From the FDC position paper: "In the final analysis, the option is *not* between having water and the more expensive anti-poor alternative of having no water. It is now a matter of economic justice, of equitably sharing the risks and benefits of a precious commodity and becoming more pro-poor and pro-people than ever."

A.C. McIntosh and C.E. Yniguez, *Privatization of water supplies in ten Asian cities*, January 2000, Asian Development Bank

Ma. Teresa Diokno-Pascual, Jude Esguerra, Rhoda Viajar and Joffre Balce, *Co-privatization, not Rate Hike, the Answer to Maynilad's Woes'*, Freedom from Debt Coalition, September 2001.

Violeta Q. Perez-Corral, *The WB-IMF/ADB at Work in the Philippine Privatization Program*, Freedom from Debt Coalition, August 2000.

<sup>1</sup> The Metropolitan Waterworks and Sewerage System (MWSS) advisory team consisted of IFC (World Bank), Sogreah/BCEOM (France) technical consultants, NERA (UK) regulatory/economics consultants, Cleary, Gottlieb & Hamilton (U.S.A) and ACCRA (Philippines) legal consultants, Punongbayan & Araullo (Philippines) and Ernst & Young International (U.S.A) financial accounting consultants and Ogilvy and Mather (U.S.A.) public relations consultants. The cost of the whole process was \$5.8 million, made up of \$3.8 million in advisor and consulting fees and \$2.0 million in success fee. A technical assistance grant of \$1.0 million was provided by the French government for the Study.

<sup>2</sup> Four consortia, each 60 percent local and 40 percent foreign were prequalified for bidding. They were Aboltiz Equity Ventures (Philippines) with Compagnie Generale des Eaux (France); Ayala Corporation (Philippines), with Bechtel Enterprises (U.S.A) and Northwest Water (UK); Benpres Holdings Corporation (Philippines) with Lyonnaise des Eaux (France) and Metro Pacific (Philippines) with Anglian Water International (UK). All four consortia bid on both East and West concessions but no one consortia was allowed to win both.

<sup>3</sup> Barring IFC's strategic advisory role in the MWSS privatization, the World Bank was not as active in the MWSS, with only a \$50-million loan in 1996 to finance the rehabilitation of the sewerage network and the Ayala treatment plant. Over the past 10 years, the World Bank has provided loans amounting to \$171 million in support of PSP in LGU water districts outside Metro Manila; ADB's contribution is \$131 million.

<sup>4</sup> Cost of arbitration was roughly \$1 million (~P40 million in 1998-99), with half the fees going to the international arbitrator. It is unsure who bore the costs of the international arbitration.

<sup>5</sup> In particular, lowering the billed volume to Maynilad's actual volume would in effect reward Maynilad for its

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## REFERENCES:

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inefficiency and mismanagement, since the latter account for a significant part of Maynilad's current high levels of non-revenue water and therefore low billed volume.

<sup>6</sup> This accelerated EPA is tantamount to the AUTOCERA (automatic currency exchange adjustment) petitioned by MAYNILAD - and thwarted by the MWSS ROI - in the past. Granting an AUTOCERA would have allowed MAYNILAD to completely escape prudential regulation with regard to foreign currency borrowing, and hence violated the spirit and principle of the 1997 Concession Agreement. Moreover, by this single act, the MWSS has compromised the integrity of the 1997 bidding process which has the effect of 'changing the rules' midstream and rewarding bid winners making wrong financial assumptions.

<sup>7</sup> For instance, Maynilad's 'non-revenue water' (NRW) which has been increasing—from 60% in 1998 to 66% last year—rather than decreasing (as projected in its financial model), could still be reduced, with better management. At present, for every three cubic meters of water it produces, Maynilad earns from only one.