

**DEVELOPMENT OF A REGULATORY FRAMEWORK FOR THE WATER AND SANITATION SECTOR
IN PARAGUAY**

(TC-95-01-28-1)

EXECUTIVE SUMMARY

EXECUTING AGENCY: Ministry of Finance, through the Privatization Council

COST:

MIF:	US\$ 980,000
Local contribution:	US\$ 220,000
Total:	US\$1,200,000

MIF FACILITY: Technical Cooperation (Facility I)

OBJECTIVES: The project's objective is to develop a new legal and institutional framework for the water and sanitation sector in Paraguay, including the establishment of a regulatory agency that is separate and independent from the system's present operators, and the creation of conditions conducive to private participation in the sector.

DESCRIPTION: To attain this objective, consulting services will be hired: (a) to prepare a diagnostic study of the existing legal framework in the sector and the legal status of the utility companies, and to formulate and evaluate feasible alternatives for the sector's institutional framework, making a recommendation on the best alternative; (b) to prepare a legal framework, including draft legislation and recommendations for the executive and legislative branches; and (c) to provide technical assistance, training, and equipment to establish the sector's regulatory agency.

ENVIRONMENTAL CLASSIFICATION: The Environment Committee classified this as a Category III operation. The Committee approved the environmental summary connected with the loan for Corporación de Obras Sanitarias (CORPOSANA) (PR-0064) at its meeting on October 18, 1994.

TYPE: Donation

PROJECT TEAM: Luis Macedo (RE1/EN1), Project Team Leader; Manuel Pizarro (RE1/EN1); Francisco Marcondes (RE1/EN1); Hugo Oliveira (Consultant); Joel Branski (RE1/EN1); Mario Yano (RE1/EN1); Cipriano Pacheco (COF/CPR); Raúl Baginski (RE1/OD1); Ricardo Rietti (RE1/SO1); and Fred Aarons (LEG).

I. COUNTRY ELIGIBILITY

- 1.1 The Donors Committee of the Multilateral Investment Fund (MIF) declared the Republic of Paraguay to be eligible for all types of financing under the MIF, effective September 16, 1994.

II. BACKGROUND

A. Operation PR-0064

- 2.1 The Inter-American Development Bank is preparing a loan operation to regulate the sector and finance urban water supply and sewerage projects in Paraguay (PR-0064). It includes a component to develop a legal and institutional regulatory framework for the sector, which has been proposed for MIF financing.

B. The current institutional and legal framework

- 2.2 Responsibility for water supply and sewerage services in Paraguay is shared by the Ministry of the Interior, to which the Corporación de Obras Sanitarias [Sanitation Works Authority] (CORPOSANA), reports, the Ministry of Health, to which the Servicio Nacional de Saneamiento Ambiental [National Environmental Sanitation Authority] (SENASA) reports, and the Ministry of National Defense, which is responsible for the Chaco region. CORPOSANA is responsible for urban areas with populations over 4,000, SENASA for rural areas – mainly localities with under 4,000 people – and the Ministry of National Defense, through the Water Supply Department for the Chaco region, for both urban and rural localities in that part of the country. There are also private companies that provide water services independently, but which often do not meet acceptable quality standards.
- 2.3 In addition to delivering services in cities with more than 4,000 inhabitants, CORPOSANA is also responsible for regulating and supervising all other water supply and sanitary sewerage systems and for recommending to the Executive Branch the licensing of such sanitation services to other public or private entities. The assignment to CORPOSANA of all three roles – delivering, regulating, and supervising the services – is inappropriate.
- 2.4 In addition to being too complex, CORPOSANA's rate system is ineffective in terms of encouraging consumers to use water rationally and allowing the utility to be financially independent. Rates are set by CORPOSANA's Executive Council and are submitted to the Executive Branch of the Federal Government for approval. The criteria applied for setting rates are not technical and there is currently no mechanism to ensure that the real value of the rates will be maintained.

- 2.5 The institutional and legal framework for water supply and sewerage services in Paraguay presents problems that warrant immediate attention. There is currently no legislation which precisely defines the operating rules for the sector, the agencies that would be involved in it, and their specific responsibilities, which discourages private participation in the sector which - when it does occur - is not subject to controls of any kind.
- 2.6 Another obstacle in the way of greater private participation in the sector is the absence of a modern and efficient rate policy. The setting of rates does not take into account the need for a utility to recover all investment, operating, and maintenance costs, service its debt, and be in a position to expand its water and sewerage service.
- 2.7 Nor has an attempt been made to use the pricing of services as a tool to achieve rational use of water, in order to postpone investments in system expansion. The main reason for the low level of water and sewerage coverage in Paraguay is the lack of an appropriate rate policy, which has made it difficult to obtain the resources necessary to expand the systems.

III. THE PROJECT

A. Objective

- 3.1 The objective of the project is to develop a new legal and institutional framework for the water and sanitation sector in Paraguay, including the establishment of a regulatory agency that is separate and independent from the system's present operators, and the creation of appropriate conditions for private participation in the sector. As was mentioned earlier, this operation will be carried out in parallel with the urban water and sewerage project (PR-0064), which is expected to be approved by the Bank in the first quarter of 1995.
- 3.2 The new legal and institutional framework for the sector seeks to distinguish between public sector responsibilities for the regulation and control of services and the responsibility for operating them, by establishing a regulatory body which is separate and independent from existing operators. By laying down rules for the sector's operations, including a mechanism for setting the rates to be charged for services, appropriate conditions will be established for private participation in delivering such services.

B. Description of activities

3.3 The following activities have been planned to attain the proposed objective: 1/

1. Preparation of diagnostic studies and formulation of alternative institutional frameworks for the water and sanitation sector

- a. Inventory and analysis of the current legal framework for the water and sanitation sector, identifying aspects that impede efficient operation by the utilities and obstruct private participation.
- b. Preparation of an analysis of the legal status of the utilities and other bodies, indicating how that status could affect the proposal for a new legal and institutional framework for the sector.
- c. Formulation and evaluation of feasible alternatives for the institutional framework for the sector, recommending the one best suited to Paraguay. The proposed alternatives should take account of: (a) the need to ensure the administrative and financial independence of the regulatory agency; and (b) the advantages of decentralizing the utilities (creating local companies), chiefly with a view to facilitating private-sector delivery of services.

2. Preparation of the legal framework

- a. Preparation of draft legislation containing rules for the operation of the sector, including aspects related to rate policy. Rates should be established at levels that allow for full cost recovery and enable the services to expand. The new legislation will have to annul and/or amend those parts of existing legislation that are contrary to it.
- b. Preparation of draft legislation on the establishment of a regulatory agency, including a determination of its powers, degree of independence, and sources of financing to make it viable over the long term. The legislation needed to implement the new legal and institutional framework for the sector will also be prepared.
- c. Advisory services for the executive and legislative branches on passing the legislation and setting up the regulatory agency.

1/ The terms of reference for the consulting services are available for consultation.

3. Establishment of the regulatory agency

- a. Design and start-up of the regulatory agency, including its institutional and organizational structure, operating and accounting procedures, definition of rules for service delivery, and draft internal regulations. A financial plan will also be prepared for year one of activities.
- b. Development and implementation of a methodology for calculating rates and mechanisms for maintaining their real value.
- c. Training for human resources and the design and implementation of an information system, including the necessary equipment.
- d. Organization of a seminar to promote wider discussion of the privatization of water and sanitation services.

IV. COST AND FINANCING

- 4.1 The MIF would provide total nonreimbursable financing of US\$980,000. The budget is presented in the following table, and the detailed project costs are given in Annex IV.

PROJECT BUDGET (in US\$)			
Category	MIF	LOCAL CONTRIBUTION	TOTAL
Preparation of the diagnostic study	100,000		100,000
Preparation of the legal framework	260,000		260,000
Establishment of the regulatory agency	400,000	145,000	545,000
Coordination	130,000	50,000	180,000
Contingencies	90,000	25,000	115,000
Total	980,000	220,000	1,200,000

V. EXECUTION AND DISBURSEMENT

- 5.1 The Privatization Council, which reports to the Ministry of Finance, will execute the project. Individual consultants and consulting firms will be hired to carry out the necessary activities. A consultant will be hired for the duration of the project to assist the executing agency in contracting and coordinating the consulting services and in preparing the semiannual reports. Goods and services will be procured in keeping with Bank and MIF procedures. The project execution schedule appears in Annex I.
- 5.2 Prior to the first disbursement of project funds, the Privatization Council must have: (a) hired the consultant to prepare the diagnostic studies and alternatives; (b) hired the consultant who will provide support for the executing agency; and (c) presented the plan for project execution and the definitive timetable.
- 5.3 The consulting services for establishing the regulatory agency may only be engaged once the framework law for the sector has been passed.
- 5.4 Disbursements will be made in accordance with Bank procedures. It will take an estimated 24 months to complete all the components, with the final disbursement scheduled for in the 30th month.

VI. MONITORING

- 6.1 The Privatization Council will present semiannual progress reports to the Bank, to be used for project monitoring. The reports must contain the following information as a minimum: (a) the progress made, with particular attention to attainment of the expected results listed in Annex III of this document; (b) difficulties or problems encountered and steps taken to resolve them; and (c) plan for executing the remainder of the project.

VII. COMPLIANCE WITH ELIGIBILITY CRITERIA

- 7.1 The technical-cooperation project to support modernization of the water and sanitation sector and private participation therein is fully compatible with the MIF's general objective, which seeks to foster and expand private investment as a way of accelerating economic growth and social development.
- 7.2 The proposal is compatible with the guidelines for using the Technical Cooperation Facility set out in Article III,

Subsections 2(c) and (d) of the Agreement Establishing the Multilateral Investment Fund, whereby grants may be provided to governments to finance advisory services to establish and/or strengthen regulatory agencies. The proposal is also consistent with the first of the strategy vectors for the Technical Cooperation Facility which is to promote private investments in infrastructure, and the MIF is financing similar programs that include the establishment of regulatory agencies for water and sanitation sectors in other Latin American countries.

VIII. ELIGIBILITY FOR MIF FINANCING

- 8.1 The program will be financed with a grant on the basis of the following considerations: (a) the Donors Committee declared the country eligible for all types of MIF financing effective September 16, 1994; (b) Section III of the country eligibility memorandum describes Paraguayan compliance with grant eligibility requirements; and (c) the proposed project will have a major catalyzing effect, as required in Article III, Section 5(a) (i) of the Agreement Establishing the MIF, since its objective is to lay the groundwork for private participation in the delivery of water and sanitation services. The validity of these criteria was confirmed at the Donors Committee meeting of March 30, 1994 (MIF/GN-23).

IX. CONSISTENCY WITH THE BANK'S COUNTRY PROGRAM

- 9.1 The proposed operation is consistent with the Bank's country strategy in that the programming paper states that the Bank will participate in financing programs for the water and sanitation sector in Paraguay to assist in defining, developing, and implementing a new legal and institutional framework for that sector. The Bank also seeks to facilitate private participation in the public services sector, and the project proposed here will spur that participation by defining the role of the government and private parties in the water and sanitation sector.
- 9.2 For its part, loan PR-0064, which parallels this operation, is aimed at upgrading the country's water and sanitation services, which is also coherent with the strategy.

X. RISKS

- 10.1 The main risk linked to this operation would be a delay in implementing the regulatory framework for the sector. If it is not implemented, the current situation - which makes it difficult for private initiative to participate - will continue. To reduce this risk, the parallel loan operation has made the disbursement of 50 percent of the funding contingent on legislation for the regulatory framework being sent to the National Congress. The country's Executive Branch has demonstrated its commitment to moving ahead with changes to permit greater private participation in the sector.

XI. ADDITIONAL DOCUMENTS

- 11.1 Since this MIF operation is parallel to the loan program (PR-0064), the loan proposal is included as Annex II to this memorandum.

XII. EXPECTED RESULTS

- 12.1 Annex III summarizes the project's activities and the expected results.

EXPECTED RESULTS

MIF - FACILITY I - PARAGUAY RESTRUCTURING OF THE WATER AND SANITATION SECTOR		
General objective of the project: To restructure the water and sanitation sector to make it more efficient and attract greater private-sector participation		
Specific objective of the project: To establish a legal and regulatory framework to allow for private investment in the sector and support the creation and start-up of the regulatory agency		
PROJECT	ACTIVITY	EXPECTED RESULTS
A. Preparation of diagnostic studies and formulation of alternatives	Inventory/diagnostic study of the legal framework for the water and sanitation sector	Legal analysis ready in four months
	Study of the legal status of the utilities	Analysis ready in four months
	Formulation/evaluation of feasible alternatives for the institutional framework	Alternatives ready in eight months
B. Preparation of the legal framework	Draft legislation for the sector	Legislation submitted to Congress within 12 months
	Draft legislation for the creation and establishment of the regulatory agency	Legislation submitted to Congress within 12 months
	Draft legislation necessary to implement the new legal and institutional framework	Legislation submitted to Congress within 12 months
C. Establishment of the regulatory agency	Design and start-up of the regulatory agency	Regulatory agency established six months after the act creating it has been passed
	Development of a rate-setting methodology	Methodology completed four months after the act creating the regulatory agency has been passed
	Human resource training	Human resources trained 12 months after the act creating the regulatory agency has been passed
	Design and implementation of an information system and provision of equipment	Information system implemented eight months after the act creating the regulatory agency has been passed
	Seminar on privatization	Seminar held within 12 months

ESTIMATED BUDGET

	MIF	LOCAL	TOTAL
I. Preparation of the diagnostic study			
1.1 Inventory of the legal framework (2 person/months)	25,000		25,000
1.2 Analysis of the legal status of companies (2 person/months)	25,000		25,000
1.3 Formulation of alternatives (3 person/months)	37,500		37,500
1.4 Seminar on privatization, preparation and implementation (1 person/month and materials)	12,500		12,500
II. Preparation of the legal framework			
2.1 Draft legislation on the regulatory framework (10 person/months)	130,000		130,000
2.2 Draft legislation on the regulatory authority (6 person/months)	78,000		78,000
2.3 Supplementary draft legislation (4 person/months)	52,000		52,000
III. Establishment of the regulatory authority			
3.1 Design and start-up of the regulatory authority (6 person/months, materials, and equipment)	138,000	100,000	238,000
3.2 Development of mechanisms for the determination of rates (4 person/months)	52,000		52,000
3.3 Human resource training (6 person/months)	78,000		78,000
3.4 Design and implementation of the information system (4 person/months, software, and hardware)	132,000	45,000	177,000
IV. Coordination (20 person/months)	130,000	50,000	180,000
V. Contingencies	90,000	25,000	115,000
Total	980,000	220,000	1,200,000

PROPOSED RESOLUTION

PARAGUAY. NONREIMBURSABLE TECHNICAL COOPERATION FOR THE DEVELOPMENT OF A
REGULATORY FRAMEWORK FOR THE POTABLE WATER AND SANITATION SECTOR

The Donors Committee of the Multilateral Investment Fund

RESOLVES:

1. That the President of the Inter-American Development Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Multilateral Investment Fund, to enter into such agreements as may be necessary with the Republic of Paraguay and to take such additional measures as may be pertinent for the execution of the plan of operations referred to in Document MIF/AT- with respect to a technical cooperation for the development of a regulatory framework for the potable water and sanitation sector.

2. That up to the amount of US\$980,000 is authorized for the purpose of this resolution, chargeable to resources of the Technical Cooperation Facility of the Multilateral Investment Fund.

3. That the above-mentioned sum is to be provided on a nonreimbursable basis.