

PROCEEDINGS AT THE CONFERENCE ON

Strengthening Regulation to Improve Water Service Performance

ADB Headquarters, Manila

August 5-6, 2008

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ACRONYMS AND ABBREVIATIONS

ADB	Asian Development Bank
CDA	Cooperative Development Authority
CPC	Certificate of Public Convenience
CSC	Customer Service Code
DILG	Department of Interior and Local Government
DOF	Department of Finance
DOJ	Department of Justice
DOH	Department of Health
EO	Executive Order
GTZ	Deutsche Gesellschaft für Technische Zusammenarbeit
IFC	International Finance Corporation
JBIC	Japan Bank for International Cooperation
LGUs	Local Government Units
LCP	League of Cities of the Philippines
LMP	League of Municipalities of the Philippines
LPP	League of Provinces of the Philippines
LWUA	Local Water Utilities Administration
NEDA	National Economic and Development Authority
NWRB	National Water Resources Board
PAWD	Philippine Association of Water Districts
PD	Presidential Decree
PWRFSP	Philippine Water Revolving Fund Support Program
USAID	United States Agency for International Development
WB	World Bank
WDs	Water Districts
WRAP	Water Regulatory Authority of the Philippines
WRC	Water Regulatory Commission
WSP	Water and Sanitation Program
WSPs	Water Service Providers
RWSAs	Rural Water Supply and Sanitation Associations

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SUMMARY OF PROCEEDINGS

BACKGROUND

The Conference on Strengthening Regulation to Improve Water Service Performance convened major players in the water sector to discuss the role of regulation in improving water service performance and to determine approaches for effective economic regulation. Representatives from water utility groups such as LGU-run systems, water districts and other service providers (including private operators, cooperatives, and rural water supply associations), local government units and leagues, concerned government and non-government entities, and donor agencies with water sector programs participated in the conference.

In the conference, experiences and best practices on regulatory approaches and recommendations on regulatory reform were presented. These served as inputs to participants in confirming medium and long-term measures for an integrated regulatory action agenda for the water sector.

Prior to this conference, consultations with various water service providers on needed regulatory reforms were conducted from July 1-3, 2008. The consultations affirmed the following:

1. A general appreciation of water service providers of the need for regulation to improve performance.
2. A consensus that a common regulatory reform agenda should be pursued to address critical concerns such as:
 - a. Unclear and overlapping roles and responsibilities of regulatory agencies;
 - b. Lack of performance standards and targets to gauge efficiency and effectiveness of water service operations;
 - c. Need for guidelines on compliance and enforcement of performance standards and targets and dissemination thereof; and
 - d. Lack of capacity to enforce regulation and monitor compliance.
3. The need for key performance indicators to guide the provision of water services and incentives to promote good performance; ring-fencing of LGU water utilities; strengthening coordination between LWUA and NWRB on their respective regulatory roles covering the water districts; and preparation of guidelines for light-handed regulation of the other service providers (private utilities, RWSAs, cooperatives, etc.).

These recommendations informed the medium and long-term reform measures proposed and discussed during the conference.

OVERVIEW OF THE WATER SECTOR

A large proportion of the population still has inadequate and unsustainable access to potable water supply. Based on NEDA's compilation of various reports obtained from NSO, DILG, LWUA, DOH, and other sector agencies, the water supply coverage may be as low as 36% of the population. No single national body is responsible for coordinating and translating the sector's policies, strategies, and goals into a comprehensive water supply program.

There are about 30 agencies with specific responsibilities for water supply, irrigation, flood control, pollution control, watershed management, financing, and policy formulation and coordination. There are also more than 6,000 registered water service providers (WSPs)

nationwide. Aside from this fragmented institutional environment, weak financing has also constrained the provision of sustainable water supply services. To achieve the MDG target of 90% access to formal water services by 2015, water supply investments should be between PhP 6 billion to PhP 7 billion per year.

The Philippine WSS Roadmap was formulated to provide an enabling environment to hurdle the constraints faced by the sector in a holistic approach. It covers institutional, regulatory, financing, and capacity-building reform agenda. The WSS Roadmap envisions the attainment of “access to safe, adequate, and sustainable water supply for all”.

INTERNATIONAL EXPERIENCES ON REGULATORY APPROACHES

Presentations on water sector regulation and reform in other countries, including lessons learned and best practices, provided the participants with diverse perspectives on regulatory approaches. The speakers highlighted key features for a successful water utility reform, prerequisites for effective regulation and various regulatory approaches adopted in other countries -- including the use of operating contracts and incentives to improve water service performance. It was also noted that regulation of more than a thousand utilities would be difficult for one regulator to undertake.

Based on international experiences, the following are the recommendations for regulatory reform in the Philippines:

1. Segmentation of market where utilities are treated/regulated differently;
2. Clear legal authority for the regulator;
3. Regulation of only the “regulatable” segments (e.g. bigger utilities);
4. Implementation of contracts, performance agreements & competition for the market;
5. Provision of incentives for consolidation;
6. Use of public financing instruments to require cost reflective pricing & business plans;
7. Promotion of commercialization by requiring corporatization and/or contracting for communities with more than 15,000 connections; and
8. Conduct of innovative contract trials (e.g. bulk-based method, short term operating contracts).

Japan’s experience in sanitation service development, including its financing and regulatory frameworks, emphasized the importance of incentives and resources to implement sanitation services. In Japan, the development of the sewerage infrastructure is treated as both a national and public responsibility. The prefectural and city governments handle sewerage installation and improvement, and municipalities are highly subsidized. A sustainable financial base for sanitation services, which includes a) federal and local subsidy system; b) local bond offering; and c) collection of user fees (or payment by beneficiaries), was established by the national government through legislation. The government sets the national guidelines for sewage services, while the JSWA provides technical support through its engineers, constructs the core facilities, conducts trainings, and undertakes technical development and assessment of sewage projects for the local governments.

PROPOSED MEASURES FOR REGULATORY AND UTILITY REFORM

The regulation of Philippine water utilities will promote efficiency standards and push service improvements and coverage expansion. It would also address various concerns such as lack of

information, pollution, resource sustainability, health, and safety. With this view, the following medium and long-term regulatory and utility reform measures were proposed:

Medium-Term Measures

1. Institutional Measures:

Role of NWRB

- Provide regulatory guidance to the sector
- Act as an appellate body – provide alternative dispute resolution mechanism
- Continue to be the economic regulator for private utilities
- Transition to full regulation of WDs, with support from LWUA in the review of WD tariffs
- Regulate LGUs on consensual arrangement
- Institute benchmarking and set performance standards

Role of LWUA

- Focus on being a specialized lending institution and provider of technical services

Role of LGUs

- Ensure the provision of water supply and sanitation in their respective jurisdictions
- Ring-fence their water-operations and enter into performance contracts for service delivery
- Adopt NWRB performance standards
- Provincial LGUs to institutionalize benchmarking of WSPs
- Role of Provincial LGUs & Municipal LGUs in regulating WSPs

2. Incentives:

- Align public financing with governance, performance & regulatory reform objectives
- NG to provide incentives to encourage financing to expand coverage especially in poor communities
- NG to provide incentives to encourage financing of WSPs meeting performance standards

3. Capacity Building:

Strengthening of NWRB

- GOP approval of reorganization proposal
- Dialogues with LWUA on regulatory functions (tariff & standards)
- Formulation of light handed regulation

Strengthening LGU capacity

- Preparation of provincial master plans
- Ring fencing of LGU operated systems

Strengthening of LWUA

- Amendment of EOs 279 & 421
 - Review of creditworthiness concept
 - Scrapping of post-retirement conditions for LWUA staff

- Review of LWUA tariff methodology/benchmarking & WD categorization parameters
- Organizational Structuring
- Review of lending terms/policies

Strengthening of WSPs

- Ring-fencing
- Business planning
- Performance standards

Long-Term Measure

- Establishment of a single economic regulatory body

The recommended measures were the subject of succeeding discussions during the conference.

An examination of the current state of Philippine water regulation by an international regulatory expert revealed that economic regulation is extremely fragmented. LGUs essentially self-regulate; there is unclear responsibility (i.e. whether by LWUA or NWRB) of regulating the water districts; and a large number of SSWPs -- the gap fillers in the water sector -- are not being regulated at all.

Given this, it was proposed that NWRB provide national guidance to improve water sector performance. To beef up NWRB's role, it needs to:

1. Increase its budget
2. Work on the secondment of staffs from other government entities
3. Clarify regulatory roles with LWUA
4. Mobilize donor support, particularly for the medium-term action plan.

Other necessary initiatives to solve ownership, governance, and resource issues, however, need to go hand in hand with regulatory reform. These initiatives include ring-fencing of LGU accounts; performance-based contracting of services to improve governance/accountability; clustering of systems to increase economies of scale, technical and financial capacity; and financing.

PANEL DISCUSSIONS

ED Ramon Alikpala, NWRB; Usec. Jeremias Paul, DOF; Dir. Paisal Abutazil, DILG; and Atty. Ruben Fondevilla, DOJ were the four panel members in the conference. Each was requested to react to the regulatory reform recommendations.

ED Alikpala appreciated the frank observations raised by the presentations of Mr. Antonio de Vera and Mr. John Sitton, who presented an objective view of the limitations of the NWRB and LWUA, as well as the problems in the sector.

ED Alikpala added that there is no disagreement on the goal of achieving access to water for everyone. He acknowledged that with the abolition of NAWASA, there is a need for regulation to address conflicting regulatory policies and roles. While there is a lot of talk about

consolidation of regulatory bodies, this may not be possible in the medium-term because of the existence of opposing structures. However, he opined that it makes sense to integrate and strengthen the coordination of existing regulatory bodies.

LGUs have the responsibility to provide water to their constituents -- and regulation is in their best interest. Regulation can be done through the provision of performance standards. ED Alikpala welcomed the separation of NWRB's resource and economic regulation functions. He also emphasized the fiscal requirements critical to effective regulation.

Undersecretary Paul agreed that financing -- like regulation -- is a means to an end. Financing and regulation should complement each other and focus on outcomes. Financing may be used as an incentive for WSPs to perform -- which would require performance standards. However, without regulation and enforcement, there would be no expansion.

Usec. Paul assured that the DOF is prepared to support and advocate financing and regulatory reforms. To push for sector reforms, the DOF is willing to provide project preparation financing facilities, support capacity building initiatives, and structure capital financing to improve the creditworthiness of WSPs.

Usec. Paul further noted that there is no legal impediment to ring-fencing LGU accounts and DOF indeed encourages it. Regulation calls for fiscal autonomy, and the DOF is supportive of providing more resources, including financing, to NWRB to enable it to carry out its regulatory function, with the cooperation of the DBM. On privatization, he noted that it is immaterial whether the facilities are run by the government or by the private sector -- as long as these are run efficiently. This emphasizes the need for regulation to recover costs and attain operational efficiency. The ability to charge appropriate tariffs would facilitate effective service delivery.

Dir. Abutazil said that in line with DILG Secretary Puno's policy to empower LGUs to govern and to exercise their corporate powers, the DILG encourages ring-fencing and corporatization of local government-operated water services. While much has already been done in the exercise of governmental power, there is still a need to focus efforts on the corporate powers of LGUs. To assist them, the DILG, through the assistance of ADB, will issue guidelines on how LGUs can exercise their corporate powers effectively. The Director stressed that LGUs need to corporatize their economic enterprises (including water and sanitation utilities) to de-politicize their operations and leverage their resources.

Atty. Fondevilla noted that to enhance the effectiveness of the Board, its members should serve on a full-time basis. As the need for an independent economic regulator is well recognized, NWRB must have a substantial budget in order to function effectively and efficiently.

When asked about the possibility of NWRB being entitled to automatic appropriations through the revenues it remits to the national treasury, Atty. Fondevilla said that this may be possible but it would require legislative amendment (i.e. the Water Code). Usec. Paul then added that the DOF would be willing to support this. Another option is to reorganize the NWRB to attain fiscal autonomy, thus enabling it to provide better services to its clients.

BUZZ GROUP AND WORKSHOP DISCUSSIONS

Divided into various groups, the participants discussed their concepts of economic regulation. Keywords such as tariffs, balancing interests of providers and consumers, policies and rules,

supervision and control, standards, and key performance indicators were highlighted in the discussions.

The results of the buzz group discussions confirmed the participants' common understanding of the meaning of economic regulation and what it entails. This set the tone for succeeding discussions on "how economic regulation can be pursued in the medium and long-term."

The participants were again divided into four heterogeneous groups to:

1. Comment/react on proposed institutional measures;
2. Suggest other institutional reforms;
3. Identify priority actions for the next 12 months; and
4. Discuss and comment on the long-term recommendation to create a single regulatory body.

CONSENSUS POINTS/ REGULATORY REFORM AGENDA

Group presentations revealed a consensus on the need for the proposed institutional measures. The agreements of the groups are as follows:

1. NWRB should continue to be the economic regulator for private utilities; provide guidance to the sector, especially on the institutionalization of benchmarking and performance standards; and regulate LGUs on consensual arrangements.
 - The groups also recognized the issue of NWRB's conflicting role as an appellate body and as an approving body for water tariffs. NWRB and LWUA will coordinate to discuss transition mechanisms to full regulation of WDs by the NWRB and review of tariffs per EO 123.
2. LWUA should be the provider of technical assistance to all water service providers, especially to the LGUs.
3. LGUs should be responsible for the provision of water supply and sanitation in their respective jurisdictions; work on the ring-fencing of their water operations; adopt national performance standards; and adopt benchmarking of WSPs.

The participants agreed on the following action agenda for the next 12 months and over the long-term:

Medium-Term Action Agenda:

1. Harmonization of the regulatory roles of LWUA and NWRB
2. Institutionalization of benchmarking
 - LWUA, NWRB, DILG & DOF to set the key performance indicators
3. Dissemination of contractualization of service delivery with either public or privately owned utilities as an option of LGUs or WDs to improve utility performance
4. Advocacy on water supply and sanitation concerns and need for regulation
 - Advocacy with the LCEs within the next 6 months; LPP to elevate WSS concerns to the President and support regulatory reform measures
5. Capacity building for LGUs on
 - a. Ring-fencing
 - b. Benchmarking
 - c. Provincial master planning

- d. Others (corporatization of water utilities, contractualization and joint ventures for WSS projects)
- 6. Finalization of guidelines on light-handed regulation
- 7. Review of proposed EOs and other legislations towards an independent regulatory body to be led by the Road Map Committee/TWGs
 - Conduct of consultations among stakeholders
 - a. Forum involving proponents of related EOs & other legislations
 - b. Conduct of forum in October with legislators and selected WSPs
 - Harmonization of existing bills on water regulations and proposal to set up apex body
 - Drafting of a consolidated bill within 6 months
 - Profiling of congressional & house committees to be involved thru PLCPD
 - Push for sponsorship & deliberation of consolidated bill in the House & Senate
 - Advocate with existing Congress through the appropriate congressional/senate committees.
- 8. Establishment of a database on water supply and sanitation coverage by level of services nationwide
- 9. Formulation/updating of provincial water supply, sewerage and sanitation sector plans
- 10. Setting up of the Water Sub-committee under NEDA InfraCom to oversee the implementation of the medium-term action agenda
- 11. Follow up with DBM on the request for additional NWRB budget

Long-term Action Agenda:

Establishment of a single, economic regulatory body with the following functions:

- a. Issue licenses
- b. Formulate tariff principles/approve tariffs
- c. Set licensee targets/performance standards
- d. Monitor and enforce compliance

The conference laid out the reform agenda -- a roadmap to improve and expand water service coverage in the Philippines. Time, resources, and the commitment of stakeholders are required to traverse this roadmap and produce results. The measures identified are expected to create further awareness among concerned entities on the importance of regulation in improving water service performance and in pursuing regulatory reforms – both medium and long-term -- to ensure that every Filipino has access to sustainable water services.

BACKGROUND OF THE CONFERENCE

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The Philippine Government has long recognized the economic and social magnitude of water. As such, water resource management -- including water supply and sanitation services development -- has been given priority in the national development agenda continuously.

The government issued various fiats, including PD 198, the Water Code, the Clean Water Act, EO 279, and EO 123 to address the development requirements of the water sector, as well as concomitant issues and concerns related to the provision of water supply and sanitation services.

The Water Supply Sector (WSS) Roadmap is a parallel initiative undertaken by concerned government entities involved in the water sector. This Roadmap is a comprehensive and progressive program of action that details short (to 2010), medium (to 2015), and long-term (to 2025) goals for water supply and sanitation services development. One of the major components of the Roadmap is the preparation and implementation of a regulatory reform action agenda to address key implementation constraints within the next two years. These include:

1. Fragmented regulatory framework;
2. Unclear mandate and un-empowered economic regulator;
3. Small, disaggregated ownership of utilities;
4. Lack of clear water service performance standards and targets;
5. Ineffective enforcement of performance standards; and
6. Poor governance of utilities.

The action agenda complements the financing reforms in the water sector supported by the USAID under the PWRF.

Various sources provide water services to urban and rural households nationwide. The local government units continue to be the dominant provider, accounting for more than half of total water supply, followed by the water districts. Private utilities, cooperatives, and other independent providers account for the rest of the supply.

However, the performances of water service providers require further enhancement. The quality of water services, for instance, varies widely across providers. Water districts perform better operationally and financially than LGU-run systems. Few water utilities are able to meet 100% service coverage in their respective franchise areas. Non-revenue water of many providers still ranges from 30% to as high as 70%. Overall, a weak and fragmented regulatory environment contributes to the sluggish performance of water service providers to expand and improve the delivery of their services, as well as meet targets for increased coverage in their respective franchise areas.

Spurred by the need to have a concrete economic regulatory reform agenda for the water sector, consultations with water service providers, concerned government entities, and donor agencies were held from July 1-3, 2008. With *Improving Water Service Performance* as the overarching objective, the consultations provided the venue to discuss the challenges confronting the sector, exchange experiences and learnings, and gather recommendations to improve performance through appropriate regulatory approaches. The consultations included presentations on the advantages of regulating water service provisions and regulatory approaches, a participatory plenary, and workshop discussions.

A significant outcome of the consultations was the general appreciation by water service providers of the need for regulation. There was a consensus that a common regulatory reform agenda should be pursued to address the following critical concerns similarly identified by the three groups of water service providers:

1. Unclear and overlapping roles and responsibilities of regulatory agencies;
2. Lack of performance standards and targets to gauge efficiency and effectiveness of water service operations;
3. Need for guidelines on compliance, enforcement of performance standards and targets, and dissemination thereof; and
4. Lack of capacity to enforce regulation and monitor compliance.

There was agreement on the need to set key performance indicators to improve water service performance and for incentives to promote good performance among the providers. These necessitate benchmarking and formulation of guidelines -- in coordination with stakeholders -- and then widely disseminated to all concerned parties.

Concerns and recommendations specific to each utility group were also discussed. LGUs should be accountable for ensuring 100% water supply and sanitation coverage in their respective localities. They can address this responsibility by establishing and operating their own water supply systems, forging a partnership with the private sector, or entering into an inter-LGU cooperative arrangement. LGU-managed utilities, which can self-regulate by virtue of their delegated powers under the Local Government Code, can pursue consensual or voluntary arrangements with a national agency for the regulation of their water utilities.

Furthermore, the participants also agreed on the need to ring-fence water-related accounts. For the water districts, the challenge was to enable them to see regulation beyond PD 198, and their own shortcomings -- specifically in addressing the 60% average coverage gap. For the other water service providers (private utilities, RWSAs, cooperatives, etc.), light-handed regulation (LHR) was recognized. The guidelines on LHR should be prepared in consultation with the involved entities.

Finally, the participants saw the need for an appropriate national economic regulatory structure for the water sector, which would formulate, enforce, and monitor compliance with the prescribed performance standards and targets for the water service providers. Such a body would also serve as the repository of the much-needed data/information on the water sector. Toward this end, continuing consultations need to be conducted to firm up the rudiments of such a body.

The recommendations gathered from the consultations substantially provided the bases of the discussions, among others, during the culminating conference on regulatory reform held on August 5-6, 2008.

Guided by the theme *Strengthening Regulation to Improve Water Service Performance*, the two-day conference again convened the major players in the water sector to further raise awareness on the role of regulation in improving water service performance and discuss approaches for effective economic regulation. The conference had the following objectives:

1. Present experiences and best practices on economic regulation;
2. Discuss recommendations on regulatory reform gathered from consultations with various water service providers; and
3. Identify a regulatory reform action agenda to improve water service performance.

The convenors of the consultations and the culminating conference include the national oversight and regulatory agencies involved in water-related concerns led by the National Water Resources Board (NWRB), Department of Finance (DOF), National Economic and Development Authority (NEDA), Department of Interior and Local Government (DILG), Local Water Utilities Administration (LWUA) and local government leagues. They were supported by the Asian Development Bank (ADB), German Technical Cooperation (GTZ), Japan Bank for International Cooperation (JBIC), United States Agency for International Development (USAID), Water and Sanitation Program (WSP), World Bank (WB), and Streams of Knowledge.

PRESENTATIONS ON THE WATER SECTOR & REGULATORY APPROACHES

OVERVIEW OF THE PHILIPPINE WATER SECTOR AND THE WSS ROADMAP

Mr. RUBEN REINOSO, JR.

Assistant Director General

National Economic and Development Authority

The presentation provided an overview of the current state of water supply and sanitation services, challenges and opportunities, and the roadmap that will guide policy and institutional reforms for improving water supply and sanitation services.

The Philippine Water Supply Sector (PWSS) Roadmap is a collaborative effort among national and local agencies and institutions, non-government organizations (NGOs), and other stakeholders in the sector. Led by the National Economic and Development Authority (NEDA) and the National Water Resources Board (NWRB), with support from the German Technical Cooperation (GTZ), the Roadmap aims to harmonize the efforts and activities of the various stakeholders, both government and the private sectors, and with civil society organizations. It sets a cohesive and synchronized general direction and activities to meet the sector's challenges and objectives in line with the targets set in the 2004-2010 Medium-Term Philippine Development Plan (MTPDP) and the 2015 Millennium Development Goals (MDGs).



ADG Ruben Reinoso, Jr. providing an overview of the Philippine water sector and the WSS Roadmap.

In the longer view, the Roadmap aims for the sustainability of water supply provision, ensuring adequacy, long-term availability, and accessibility of water at a reasonable price.

In the process of its formulation, the Roadmap sets to address perennial issues in the sector, which include, among the critical ones:

1. Institutional fragmentation
2. Lack of an executive and legislative sector champion
3. Inadequate support for rural water supply
4. Low tariff and cost-recovery level
5. Low performance of water utilities
6. Weak and fragmented regulatory framework
7. Sector investment and financing
8. Lack of WSS sector information

The Paradox

The country's water resources may be described as a paradox of abundance and scarcity. It has 421 major river basins in 119 proclaimed watersheds. Together with 61 major lakes and numerous streams, these basins accumulate runoffs from rains averaging 2,400mm annually. The

country also has an estimated 50,000 square kilometers of groundwater reservoirs with a reliable surface water supply aggregate of 833 million cubic meters (MCM) per day.

Although the amount of raw water available significantly surpasses current demand, a large portion of the population does not have adequate and sustained access to potable water supply. Moreover, despite the outpour of investments for water supply in major urban centers, there is still scarcity in these areas. Prevailing problems of excessive and wasteful use, pollution of sources, illegal connections, and inefficiencies in the distribution system are causes for the shortage.

Demand Projection

Water demand increases year after year due to population growth and other factors. In a projection made under the 1998 Master Plan Study on Water Resource Management by the NWRB, the annual demand in industrial, agricultural, and domestic water will increase up to 124%, 185%, and 281%, respectively, from 1995 up to 2025. This is based on the assumptions that volume of surface water remains unchanged; mining companies, the main industrial user of surface water, will have ceased to operate on or before 2025; and, 30% of ground water is reusable until 2025.

According to the same study, nine (9) major cities (Metro Manila, Cebu, Davao, Baguio, Angeles, Bacolod, Iloilo, Cagayan de Oro, and Zamboanga) will experience critical water needs by 2025. According to another study by the Japan International Cooperation Agency (JICA), in Metro Manila alone, demand will reach up 1.9 BCM/year by 2010.

Access and Coverage

At present, and as observed during the Roadmap process, it is difficult to measure water supply access and coverage with high accuracy. Current monitoring systems and linkages have yet to be strengthened or developed to come up with a synchronized and precise measure of the extent of access and coverage in the country. As it is, rough estimates from NSO, LWUA, and DILG vary in methodology and outputs.

According to NSO, in 2000, 46.13% of households had access to Level II and Level III water supply systems. LWUA, meanwhile, reports that as of 2007, 24.15% of households had access to Level III water supply systems of water districts (WDs). Based on DILG's monitoring of Provincial Water Supply Sector and Sanitation Sector Master Plans (PW4SPs), 21.6% of households have access to various water supply systems.

Information from these sources were consolidated (i.e., using same base year, DILG data for areas outside NCR and NSO data for areas within NCR), resulting to a rough estimate of water supply coverage at 36% for the whole country.

Institutional Environment

Constraints in the current institutional settings slow down progress in the Philippine Water Supply Sector. At present, no single national body is responsible for the sector's overall coordination carrying the mandate to translate the government's policies, strategies, and goals into a comprehensive water supply program covering the urban and rural areas.

There are currently 30 agencies involved in the sector with specific assignments for water supply, irrigation, flood control, pollution control, watershed management, financing, policy formulation, coordination, and others. Only a few, however, are directly engaged in water supply development, namely, LGUs, LWUA (and WDs), MWSS, and more recently, the DILG, and NAPC-WASCO with DPWH for the President's Priority Project on Water (P3W).

There are more than 6,000 registered water service providers (WSPs) nationwide, consisting of Water Districts (WDs), LGU utilities, Rural Water & Sanitation Associations (RWSAs), Barangay Water & Sanitation Associations (BWSAs), cooperatives, and private utilities.

Financing and Investment

Weak financing is a major restraining force in the water supply sector. To achieve the Millennium Development Goal target of 90% access to formal water services by 2015, estimated water supply investments should be in the range of Php6 billion to Php7 billion per year. Actual investments during the last two decades, however, have fallen short by almost 50% of the requirement and were skewed heavily toward Metro Manila (WB 2005). The bulk of public investments were channeled through MWSS and LWUA — both of which are currently facing financial constraints.

Local public utilities, on the other hand, remain underinvested with aggregate LGU investments averaging Php400 million a year, mostly for recurring expenditures. Investment planning for expansion is weak and is dependent on national government-facilitated investments through on lending to national sector agencies (like LWUA and MWSS) and through government financing institutions (GFIs), small grants for community-driven initiatives, and through congressional allocations, which are generally selective in nature.

Private financing for the sector has become more significant since the late 1990s, after the enactment of the National Water Crisis Act of 1995 that paved the way for the privatization of MWSS. The two concessionaires (MWSI and MWCI) have put in an estimated Php16 billion in capital expenditures since 1997. Nevertheless, these investments are concentrated in Metro Manila. Household private investments, on the other hand, are estimated at Php235 million per year.

Our vision is to provide “access to safe, adequate, and sustainable water supply for all.” The sector’s vision is a holistic scenario of the future -- encompassing the elements of water quality and safety, adequacy, sustainability, and universal access.

Safety relates, among others, to the need for water supply and wastewater management and sanitation. Adequacy relates to insufficiency of supply against demand. Among the poor, adequacy directly corresponds to problems of affordability. Sustainability relates to financial sustainability of water supply systems and wastewater management. It is also associated with low levels of awareness among water users on the value of water as an economic and public good; weak regulatory framework on pricing and cost recovery; and the general threat on supply due to environmental degradation and bad practices in water resource management.

The overarching goal is to have universal access in recognition of the human right to water and the special concern given to the poor and the disadvantaged.

SYNTHESIS OF THE 3-DAY CONSULTATIONS WITH THE WATER UTILITIES

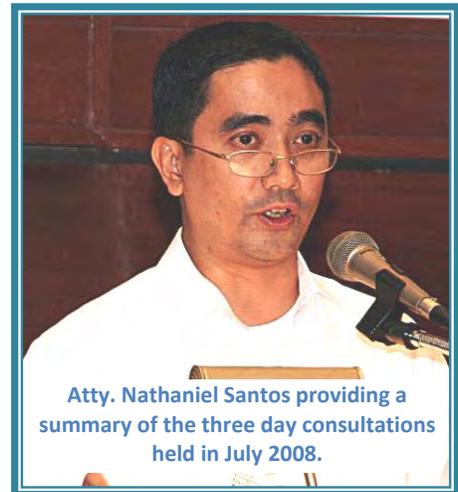
Atty. NATHANIEL SANTOS

Deputy Executive Director
National Water Resources Board

A summary of the findings and recommendations that emerged from the recent consultations with water districts, LGU-managed water utilities, and privately operated water systems was presented as part of the background of conference.

Prior to this conference, a series of consultations lasting for three days convened major players from the water service on July 1-3, 2008 to gather recommendations on how to improve regulation of the water utilities to meet service coverage targets and performance standards. Among others, the consultations provided the venue for discussions on the advantages of regulating water service provision.

During the 3-day pre-conference last month, a day was devoted to each of the three major categories of water service providers in the Philippines -- the LGUs, water districts, and small-scale private providers, including cooperatives and homeowners associations, to come up with medium and long-term recommendations to pursue regulatory reforms to enhance governance of water utilities to achieve water service standards and targets.



The general outcome of the pre-conference consultations included the appreciation by water service providers of the need for regulation to improve performance. There was a consensus to pursue a common regulatory reform agenda to address the following critical concerns:

1. Unclear and overlapping roles and responsibilities of regulatory agencies;
2. Lack of performance standards and targets to gauge efficiency and effectiveness of water service operations;
3. Need for guidelines on compliance and enforcement of performance standards and targets; and
4. Lack of capacity to enforce regulation and monitor compliance.

The need for key performance indicators to guide the provision of water services and incentives to promote good performance was also recognized during the consultations.

The consultation with LGU-managed water utilities on the first day came up with a number of recommendations, namely:

1. Ring-fencing of LGU accounts;
2. Preparation of performance standards, coverage targets and guidelines for LGUs;
3. Advocacy on economic regulation to local chief executives, local councils, and waterworks units.

In the long-term, the establishment of the mandate/authority of a national body to enforce regulation and sanctions for non-compliance was recommended.

To support the recommendations made, there was also a general agreement to undertake the following measures:

1. Dissemination by DILG of the results of the benchmarking exercise, particularly to those who participated in the exercise;
2. Conduct of benchmarking of water utilities;
3. Identification of key performance indicators (starting with those identified in the DILG benchmark study) and timeline/assignment of performance targets by each utility; and
4. Dissemination of guidelines by concerned national agencies.

On the second day, which involved the water districts, the discussions brought out the following observations/conclusions:

1. WDs and LWUA seemed unable to see regulation beyond PD 198.
2. The reactions from WDs focused only on operational issues and no specific recommendations were offered to improve service performance, specifically to address the 60% service coverage gap.
3. Although LWUA opined that its mandate as financier, technical assistance provider, and regulator is working and should remain as such, LWUA is not designed as an independent economic regulator. Its tariff-setting function is focused more on ensuring that its loans are repaid.
4. LWUA and NWRB's tariff-setting guidelines need to harmonize.
5. There is a need to come up with benchmarks for WD performance to improve service delivery and coverage.

The third day of the pre-conference consultations was conducted with private utilities, rural waterworks, water cooperatives, and others. The major recommendations on that day are as follows:

1. NWRB will formulate a customer service code (CSC) or manual which will bind the agency to WSPs -- in the same way that WSPs bind themselves to the households they serve through their own respective CSCs.
2. Light-handed regulation is needed and could be availed of, provided certain conditions are met -- i.e., good standing, meeting a certain service coverage target, etc.
3. NWRB and the CDA will meet and agree on regulatory arrangements (e.g., tariffs, depreciation reserve fund).
4. Accreditation of tariff reviewers, whose fees can be recovered within the tariff proposal, will be pursued.
5. Provisional certificates of public convenience (CPCs) can be granted based on performance.

These recommendations will be further discussed during the conference to come up with a more defined regulatory reform agenda for the water sector.

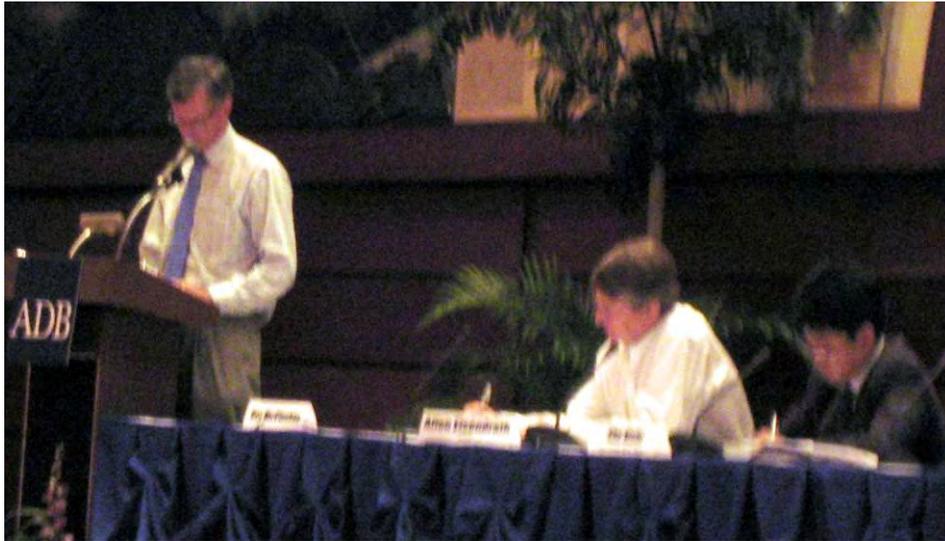
INTERNATIONAL EXPERIENCE IN WATER UTILITY REGULATORY REFORM

Mr. ALLEN EISENDRATH

Energy Team Leader

Office of Infrastructure & Engineering

USAID



Mr. Del McCluskey introducing the conference resource speakers on international experiences on regulatory approaches, Mr. Allen Eisendrath and Mr. Shu Nishi.

The presentation included lessons learned and best practices in water sector regulation and reform, including approaches adopted in other countries (e.g. the use of operating contracts and incentives to improve water service performance) to provide participants with international perspective on regulatory approaches.

The presentation showed how other countries have implemented a vision of safe and sustainable water for all. It explained key features of successful water sector reforms in terms of water and sewerage services moving toward high standards of service and financial and operational sustainability, and reviewed models that other countries have used to reform their water utilities. The topics covered included the following: key features of successful water sector reform, prerequisites for effective regulation, results of the USAID “good practices” study, and contractualization and aggregation.

Key Features of Successful Reforms

Based on an examination of about 35 countries¹ that have worked on reforming their water sectors, there are four key features of their reform programs that have led to success. These features can serve as general criteria with which to evaluate any reform proposals:

¹ Armenia, Australia, Brazil, Bulgaria, Chile, Colombia, Cote d’Ivoire, Czech Republic, Egypt, Estonia, France, Germany, Hungary, Indonesia, Jordan, Latvia, Lithuania, Malaysia, Morocco, Netherlands, Poland, Romania, Russia, Senegal, Singapore, South Africa, Spain, Sweden, Thailand, UAE, Uganda, UK, US, Ukraine, Vietnam, and Zambia

Autonomy and accountability of the water utility

Water utilities need to be autonomous and accountable for their performance. Autonomy means they can operate as specialized public service organizations and make decisions with limited political interference. Accountability involves measuring and comparing their performance against some clearly established standards of performance. If they do not perform well, they may be made accountable and face penalties.

Incentives for reform; penalties for failure

Reform works if there are incentives for good performance, and some kind of penalties for poor performance. Reform works best if the incentives and penalties are made similar with those in well-run companies, including opportunities for career promotion, bonuses as rewards, and the possibility of getting fired and not receiving bonuses or promotions for poor performance.

Progressive performance standards

Performance standards should be progressive, with small but significant improvements in key areas each year. This means having increasing targets, which are put in regulation or in a contract.

Cost reflective pricing

Pricing needs to reflect costs. Prices need to allow the utility enough revenues to operate, maintain, and improve the system (or operation & maintenance cost = collections from customers + subsidies).

To achieve these key features, successful reformers have:

1. Complete decentralization or effective regionalization (or the establishment of regional utilities)
2. Corporatization & corporate governance reform (i.e., WSPs form a legal corporate entity which is easier to regulate)
3. An effective regulatory agency
4. Incentive-based operating contracts
5. Private sector participation
6. Shift from capital grants to sustainable financing mechanisms (such as revolving fund)

Decentralization is the most common reform approach

Decentralization works, but it needs to be done right. There are seven conditions needed for successful decentralization, namely:

1. Full, legal transfer of assets, authority, and responsibility for water and sewerage;
2. Clear, realistic, and progressive performance standards and an effective means of enforcement;
3. A mechanism for financing capital investment;
4. Corporatization of service providers;
5. Operating contracts;
6. A mechanism for setting cost-based tariffs; and
7. A transition plan

It is rare to see this model work when these conditions are not met. There are numerous cases where a reform program gets nowhere when it does not have these conditions or features.

These nine (9) regulators in the Best Practices Study were selected because they have demonstrated effectiveness in applying good regulatory practices, and the water sectors in their

respective countries have shown major improvement over time. In addition, they have adopted a full range of commonly-used regulatory methods, including incentive-based price caps, rate of return, and benchmarks. Finally, the geographical diversity of the selected regulators indicates that effective regulation exists in developing countries worldwide; it is not concentrated in a single region.

Effective Regulation Requires a “Regulatable Entity”

A “regulatable entity” is one that is accountable for its performance, responsive to incentives, and able to make its own managerial decisions. Accountability is often established through: 1) corporatization; 2) commercialization; 3) licensing; or 4) contractualization.

In most cases, accountability requires changes in law. It also depends on a framework and mechanism for good corporate governance (i.e., board procedures and composition, bylaws, charter, performance plans, and agreements).

Regulation is about incentives

Regulators set incentives and not just prices. However, incentives and public sector ownership can be a major problem. Regulating public utilities is extremely difficult, because most employees do not have incentives that are related meaningfully to either short or long-term performance. To make regulation of public companies effective, we have to find a way to provide incentives, ensure adequate autonomy and accountability, and make targets realistic, achievable, and important. In most reforming countries, this involves corporatization and commercialization, contractualization, or licensing.

Reforms usually do not achieve much without incentives to staff and management. Performance-related incentives must be linked directly to targets. Remuneration for staff and management with no incentive program will consist primarily of the basic salary and required bonuses. With performance targets (such as operating profit, electricity per cubic meter, cash collected per cubic meter, percentage of bills collected, NRW, continuity of supply, new connections, sanitation achievement, etc.), staff and management remuneration with an incentive program would include a performance bonus on top of the basic salary and required bonuses.

The key characteristics of effective regulators in the study are as follows:

1. Most successful regulators have the power to enforce economic cost recovery set in primary law;
2. Almost all have arrangements to transition from low cost recovery to full economic cost recovery over a reasonable period of time;
3. Most use a defined procedure to establish progressive performance targets. These targets are built into rates and bonus formulas;
4. Regulators that deal with large numbers of utilities say they cannot keep up with the workload of individual rate orders. They use benchmarking and set methods, not rates.

When world experts were asked on how to deal with revenue shortfalls during the transitional period, their responses included the following:

1. Regulation will not work if corporate governance does not work.

Regulators in our Best Practices in Water Utility Regulation Study:

Abu Dhabi	- Regulation & Supervision Bureau *
Chile	- Superintendent of Sanitation Services (SISS)
Colombia	- Water Regulatory Commission (CRA)
Laos	- Water Supply Authority of Lao P.D.R.
Lithuania	- National Control Commission for Prices *
Mozambique	- Water Regulatory Council (CRA)
Senegal	- SONES - Contract Regulator and State Holding Company
Ukraine	- No central regulator
Zambia	- National Water Supply and Sanitation Council (NWASCO)

* Multi-sector regulator

2. There is no revenue gap in many situations if the utility is properly governed and managed.
3. A well-run utility with good corporate governance typically has low UAW, enumerates all customers, bills most water delivered, and collects most bills.
4. By promoting fundamental things like increasing collection and stopping losses (theft, leakage), regulators improve the quality and reliability of service, strengthen management, and close cash-flow gaps.
5. During transition, regulators can function in an advisory role to help water utilities prepare business plans, improve business processes (including metering, billing, and collections), determine asset condition, develop information systems, and obtain financing.

Some ways of setting improvement targets during the early stages of transition include:

1. Setting a common transitional goal of requiring operating income to match operating costs
2. Establishing a mechanism for resetting progressive performance targets: contractualization or benchmarking
3. If allowed under civil service rules, regulators can function as technical auditors to authorize bonuses based on results
4. Tariff and subsidy design can be powerful incentives for improved performance by directing financial rewards to specific outcomes that affect performance targets, monitoring, and reward/penalty systems.

Many countries use contractualization to establish incentives and set progressive targets. Contracts range from performance agreements to lease contracts, to concessions, partial divestiture, and full divestiture (not necessarily privatization). Innovative ways are being found to “contractualize” relationships with public sector employees. Some LGUs split assets to allow some units to operate the business – a common practice among water business operations. This allows shorter contract periods, more meaningful short-term performance target setting, and reduces investor risk. Incentives include share of operating income or net profit, fixed fee per cubic meter billed and collected, and fixed operating margin.

Examples of Contractualization

In Lahur Town, Maharashtra, India, bidders propose a bulk supply price for a 5-year operating contract. The highest bulk payment (per cubic meter) wins the contract and operates the water treatment plant, transmission, and distribution for 5 years. All capital expenses associated with customer connections and tertiary networks are the operator’s responsibility. The operator figures out the best way to deliver, bill, and collect water. The system transfers back to the Water Board at the end of 5 years.

Another variation on the contracting model is the case of Aquarius & Co. in Poland. Piaseczno City owns all assets, but allows three operating contracts: urban stormwater; urban water and wastewater; and rural water and wastewater. In 1989, former employees of a public service provider established a private company called Aquarius to operate water and wastewater services. Aquarius won the urban water and wastewater, and storm water contracts. In 2003, all urban assets were re-competed under a ten-year lease, and Aquarius won. This variation shows the range of solutions that cities and towns come up with under this larger model. Also, this shows how former employees can prosper under the reform program, a step-by-step evolution of contracts, and how new corporate forms and contracting approaches can evolve along with strong incentives for performance improvement.

Another variation is the operating lease model in Lodz, Poland. Here, the city established two commercial law joint stock companies to operate water and wastewater services where shares

are 100% owned by the Lodz government. Water and wastewater assets are owned by the city and leased to the operator and the lease contracts specify annual performance targets. The city puts assets under an Asset Holding Company to deal with tax issues and financing needs.

In Uganda NWSC, achievements in contractualization are shown by improvements performance indicators such as increased service coverage, higher total connections, higher new connections per year, reduced staff per 100 connections, increased collection efficiency, lower unaccounted water, greater proportion of metered accounts, higher annual turnover, and higher profits.

The Islamic Republic of Afghanistan has just formed a public water and sanitation company that is essentially just a holding company. It has operating divisions called Strategic Business Units (SBUs), which are the bigger towns and cities in the country. The Afghan Urban Water Supply and Sanitation Company (AUWSSC) will sign performance agreements with management of these SBUs. The performance agreements will specify the performance targets, items provided by AUWSSC, such as the capex, operating subsidy, and any special kind of incentives and technical support. In addition, the SBUs will pay a lease fee to AUWSSC to help defer the cost of capital replacement and renewal. The SBUs will then make their money by improving the delivery, billing, collection of water, and by managing their costs carefully.

Finally, the aggregation in Romania has shown that the larger the utility, the lower the cost per unit. In the Philippines, there are about 6,000 WSPs. Nevertheless, there is a good amount of evidence showing that larger utilities can bring down per unit costs.

Recommendations for Water Regulation in the Philippines

To put it all together, some recommendations that can be applied in the Philippine setting include:

1. Treating each market segment differently (do not try to regulate 5000 service providers)
2. Making sure that the regulator has legal authority to regulate -- this may require an amendment to law
3. Regulating only the regulatable segments
4. Encouraging the use of contracts, performance agreements, and competition for the market
5. Providing incentives for consolidation
6. Using public financing instruments to require cost reflective pricing and business plans
7. Promoting commercialization by requiring corporatization and/or contracting for communities that are greater than 15,000, and
8. Conducting innovative contract trials such as bulk-based method and/or short term operating contracts.

JAPANESE EXPERIENCE IN DELIVERING IMPROVED SANITATION SERVICES

Mr. SHU NISHI

Vice Director, Planning Design Division
Japan Sewage Works Agency

The presentation provided information on sanitation service development in Japan, including its financing and regulatory frameworks.

As a background, the Japan Sewage Works Agency (JSWA) provides technical support to government and has over 100 years of experience. It is responsible for 70% sanitation service coverage.

The presentation is divided into the following parts:

1. History of the sewerage system in Japan
2. Development of the legal system and
3. Financial resources (construction and management)

The history of the sewerage system in Japan

Various incidents and events, which occurred over the past 100 years, triggered the development of the sewerage system in Japan. In the 1870s, the spread of cholera created the need to keep the land clean. As such, the sewerage law was established. Flooding in the 1950s resulted in the revision of the Sewerage Law, while the need to control water pollution and conserve energy led to amendments of the Sewerage Law in the 1970s and 1990s, respectively.

Background	Purpose	
1870s: Spread of cholera	Keep the land clean	1900: Sewerage Law was established
1950s: Flood in urbanized areas	Urban Flood Reduction	1958: Sewerage Law was revised
Necessity of sanitary facilities	Improvement of Public Health	
Water pollution in public bodies of water	Conservation of water quality in public bodies of water	1970: Sewerage Law was amended
		1970: Water Pollution Control Law
1990s Conservation of Energy	Leverage Resources to Conserve Energy	1996 Sewerage Law was amended
		1993 Basic Environmental Law

The Development of the Sewerage System in Japan

Several factors hindered the development of the sewerage system in the Japan. These include:

1. Lack of public knowledge on the importance or necessity of a sewerage system
2. Shortfall of financial resources
3. Shortage of engineers

Lack of Public Knowledge

The spread of cholera in the 1870s, the prevalence of water pollution in rivers and other public bodies of water, and serious concern over environmental pollution in the 1950s gave impetus to the recognition of the importance of sanitation facilities. To create awareness on the necessity of developing a sewerage system, the National Government and Municipalities employed educational and public relations programs. The basic sanitary system focused on water supply, sewerage system, and waste clean up.

Shortfall of Financial Resources

It is very difficult to gain profit through the sewerage works because the cost of developing the system is high while the collection of user's fees is difficult. However, a sewerage and sanitation system is a basic infrastructure and its development is a national minimum. As such, the public must share in the responsibility for its construction and development. Moreover, the sewerage system has a big impact on economic output. If sanitation conditions improve, so does productive capacity.

Investments in sewerage system are justified mainly by socio-economic benefits (i.e., improvement of the living conditions, conservation of water quality, etc.). As such, the provision of incentives and subsidies is justified. In Japan, the National Government used the force of law to establish a sustainable financial base by setting up a subsidy system, issuing local bonds, and collecting user fees (or payment by beneficiaries).

Shortage of Engineers

To address the lack of engineers in the local government, the National government drafted technical guidelines; and with the local government, set-up the Japan Sewage Works Agency (JS), which was responsible for providing technical support through the dispatch of engineers, construction of core facilities, conduct of trainings, and technical development and assessment.

Technical Guidelines

Among the major technical guidelines published by the JSWA include:

1. Guidelines for sewerage facilities planning and design (process of plan making, design procedure of facilities, etc.)
2. Guidelines for comprehensive plan of regional sewage improvement (basic policy of sewerage maintenance, pollution load and pollution analysis, calculation of estimated sewage flow, allocation of necessary facilities and decision of capacity, etc.)
3. Guidelines for earthquake resistance standard of sewerage facilities (procedures for earthquake resistance standards, calculation of formulas, etc.)
4. Guidelines for sewerage maintenance and management (creation and management of accounts/ledger, maintenance work such as checking, inspection, cleaning, and dredging, rehabilitation methods, and measures for accidents, etc.)

Training Programs

The JSWA offers training programs (which are also open to foreign trainees) consisting of five courses (planning, management, detail design, construction supervision, and operation/maintenance) covering various subjects relating to sewerage. These are:

Course	Subject
Sewerage Planning	Introduction to sewage works Sewerage master plan
Sewerage Management	Sewerage Management Measures for delinquent sewer rate
Detail Design	Sewers Sewer rehabilitation and construction supervision Wastewater treatment facilities
Construction Supervision	Construction Supervision
Operation and Maintenance	Measures for infiltration/inflow Treatment facility operation Introduction to water quality control Troubles regarding water quality control

Development of the Legal System

There is a need for a legal system to enforce the development of sewerage systems. As such, regulation and control by the National Government is important. The development of the legal system covers regulation, control, system of approval, right of inspection, and right of fee collection. These are contained in the Japanese Sewerage Law. The following points must be considered regarding the development of the legal system:

1. Clarify the roles and responsibilities between the National Government, Municipality, and the Public (i.e., land owner, homeowner)
2. Set up the technical criteria for regulation
3. Set up regulation on the usage of the sewerage system (i.e., rules on construction of drainage facilities, sewerage system connections and disposal of safety equipment)
4. Address implementation constraints
5. Establish a system of checks and controls
6. Set up financial system (i.e., usage fees, payment of beneficiaries, subsidy system, free loan, and transfer of government-owned land)

Financial Resources (Construction and Management Cost)

The construction, management, and continuous maintenance of the sewerage system entail huge, long-term costs. As such, it is crucial to establish a sustainable financial base. In Japan, since the sewerage fee is not enough to cover all administration costs (construction and O&M), a national government subsidy and the issuance of local bonds are necessary. The money transferred from the national account makes up for the difference due to low sewerage fee collections. For example, the cost of the construction of a wastewater treatment plants is accounted for by government subsidy (55%), local bonds (40%) and users' charges (5%).

On the administrative side, financial inflows or income is derived mainly from transfers from the national government (40%) and sewerage fee collections (60%). About 70% of the administration cost goes to the refund of local bonds and the rest to management cost (i.e., personnel cost, repairs, etc.).

To recap, the development of the sewerage infrastructure is both a national and public responsibility as the improvement in sanitation conditions improves productive capacity. Investments in sewerage systems are justified mainly by socio-economic benefits (i.e., improvement of the living conditions, conservation of water quality, etc.). The National Government established the subsidy system to develop and spread the sewage system. , Recognizing that sewerage services are not a viable business undertaking, it also issued local bonds at low interest rates. Furthermore, it also gives back some of the land asset value improved by the sewage system (payment by beneficiary). Last, it also collects user fees where consumers pay the cost according to the Polluter-Pays Principle (PPP).

PROPOSED MEASURES FOR REGULATORY & UTILITY REFORM

ADVANTAGES OF REGULATION AND PROPOSED MEASURES

Mr. ANTONIO DE VERA

Consultant, GTZ

The advantages of regulations on Philippine water utilities and proposals for medium and long-term regulatory and utility reform measures were discussed for the consideration of the participants during workshop discussions.

Water utilities are natural monopolies. As such, regulation is needed as a proxy for competition (i.e., promotes efficiency standards, service improvements, and coverage expansion); and to address a range of market failures -- such as lack of information, pollution, resource sustainability, and health and safety.

There are advantages of economic regulation for various sectors:

1. For customers: ensures water quality and service levels, protects against unreasonable prices, and provides grievance or appeal procedures
2. For the community: ensures adequate coverage levels and service sustainability
3. For the utility: ensures recovery of investments, provides incentives for efficiency, assures operational viability, and provides relief from unwarranted interferences
4. For the society: provides stability and economic development

Currently, the regulation of the water sector falls under several agencies, such as the NWRB for resource utilization, the DENR for environment, and the DOH for health. Economic regulation -- which involves price setting and financial aspects; monitoring and enforcement; and technical/customer service standards -- falls under many agencies.

The NWRB and LWUA regulate water districts (WDs); the LGUs regulate LGU-run systems and LGU-contracted private systems; and the national agencies, such as PEZA and the MWSS, regulate industrial zones and MWSS concessionaires, respectively. Private systems and rural water associations are unregulated.

There are different tariff methodologies being followed. Government agencies, namely NWRB and LWUA, use return on assets and cash flow, respectively. Contract-based regulators also use other methodologies. MWSS-RO uses return on investments with appropriate discount rate (ADR). SBWRB uses return on equity, while CDC uses internal rate of return. Meanwhile, LGUs use cash flow and other considerations.

Under the existing regulatory framework, economic regulation -- currently done by many agencies -- is fragmented with overlaps. The economic regulators do not have either the resources or enforcement authority. LGUs find it difficult to do proper economic regulation because of their political environment, multi-functions, and short-term planning horizons. Meanwhile, the NWRB finds it difficult to do proper economic regulation for the following reasons:

1. Economic regulation is fundamentally different from resource regulation. The former entails financial and business management skills rather than those of resource planning and engineering. NWRB's primary mandate is resource regulation
2. It is not given enough resources for economic regulation (e.g. staff limitations)
3. Lack of penal provisions for violations

4. Board members are not on full-time basis and they can be changed anytime
5. They have no authority to review sewerage tariffs

Similarly, LWUA finds it difficult to do proper economic regulation for the following reasons:

1. There is lack of penal provisions for violations
2. The step-in rights are applicable only for loan arrears
3. The withdrawal of CCC has no consequences
4. The authority of LWUA over WDs w/o LWUA loans is unclear
5. There are conflicts in being a financier and regulator

International experiences show that there is no “universal model” of a regulatory framework. The country’s wider legal, administrative, and commercial arrangements that are in place have to be considered. An arrangement for a highly-centralized state will be different from those where power and responsibilities are diffused to local governments. In all countries with water economic regulators, the water resource and health regulatory responsibilities rest with other agencies.

Regarding institutional reforms, the medium-term recommendations include:

- 1) For NWRB to be the economic regulator for private utilities; transition to full regulation of WDs; regulate LGUs on consensual arrangement; institute benchmarking and set performance standards for WSPs
- 2) For LWUA to focus on its role as a specialized lending institution and provider of various services
- 3) For LGUs to ensure ring-fencing of LGU-run systems; adopt and institutionalize benchmarking and performance standards for WSPs in their respective jurisdiction

Regarding incentives, the medium-term recommendations are:

1. To align public financing with governance, performance and regulatory reform objectives
2. National government to provide incentives to encourage financing to expand coverage, especially in poor communities
3. To encourage financing of WSPs which meet performance standards

To strengthen NWRB in the medium-term, there should be GOP approval of the reorganization proposal, dialogues with LWUA on regulatory functions (tariff and standards), and formulation of light-handed regulation.

To strengthen LWUA, there should be an amendment of EOs 279 and 421, especially the review of the concept of creditworthiness and scrapping of post-retirement conditions for LWUA staff, a review of LWUA tariff methodology/benchmarking and WD categorization parameters, an organizational structuring, and a review of lending terms and policies.

To strengthen WSPs, ring-fencing, business planning and performance standards are recommended.

The long-term recommendation is for the formation of a single national economic regulator, which will issue licenses, formulate tariff principles and approve tariffs, set licensee targets and performance standards, and monitor and enforce compliance.

REACTIONS ON REGULATORY REFORM MEASURES FOR PHILIPPINE WATER UTILITIES

Mr. JOHN SITTON

Technical Director for Public Services
Emerging Markets Group

Session Objective: *Examine the current state of water utility regulation in the Philippines, discuss proposed measures for improving regulation, and present how regulation fits within the broader framework of efforts to improve water and sanitation services.*

Regulation is a means to an end. The key objectives of regulation for the Philippines are to increase improved water and sanitation access -- especially to poor communities, improve operating performance, and move toward cost-recovery tariffs.

The current economic regulation of the water sector is extremely fragmented and incomplete. LGUs are essentially self-regulated, yet do not have the resources or expertise. In addition, most LGU water service providers are not ring-fenced — making them impossible to regulate properly. It is also unclear — between LWUA and NWRB — who has the responsibility to regulate water districts. LWUA appears to review tariffs only for WDs that have outstanding loans; thus, some WDs are not being regulated. Meanwhile, a large number of SSWPs, who are the gap fillers in the water sector, are not being regulated at all.

NWRB is remarkably under-resourced. It is functioning as a very ‘minor player’ rather than as the ‘national regulator’ for the water sector, as intended. Its attention is split between water resource management and economic regulation. Furthermore, its funding mechanism does not provide for the level of independence or sustainability needed to perform its role. On the other hand, LWUA’s dominant role is that of financier — its focus on debt repayment discourages expansion into poorer, less lucrative areas.

Proper economic regulation in the Philippines is a massive undertaking, considering the geographical spread of the Philippines, the number and variety of WSPs, and the political environment. NWRB needs to focus on “the forest, not the trees.” It should focus on increasing access to water, especially for the poor, and improving water utility performance across the country. It cannot be the sole regulator in the medium-term.

Considering the lack of ‘national’ guidance, NWRB could quickly have a significant impact on the performance of the sector, including improving service coverage, if it:

1. Provides the “vision” for a proper functioning sector
2. Establishes “national” guidelines
3. Provides “expert” assistance
4. Monitors/measures performance of the sector (e.g., ranking WSPs); and
5. Provides soft incentives (e.g., national recognition or “naming and shaming” poor performers).

NWRB needs to focus on effectiveness — it needs to be innovative in finding solutions to strengthen sector regulation, considering the politics, geographical spread, etc. In essence, NWRB should:

1. Focus on how best to achieve the desired outcomes (i.e., find a “Filipino” solution that works);
2. Deputize (or just allow) others to provide “first-level” regulation in their jurisdictions;

3. Initially establish itself as an “expert” appellate body; and
4. Train local professionals to undertake tariff reviews in accordance with the national guidelines.

Regulation is a quasi-judicial role, which fulfills an appellate function. It requires experienced, independent ‘judges’ and follows transparent, well-understood decision-making processes. It entails written decisions that are coherent (e.g., tariffs and service levels are linked), predictable and credible (i.e., based on precedent, rules), and legitimate (i.e., legal).

To be effective, NWRB needs rapid reinforcement through a significantly increased budget allocation, temporary secondment of economists and engineers from other governmental departments, a memorandum of agreement with LWUA to agree on roles, align objectives and share costs/resources, and donor support.

As it is, regulation is only part of the solution. Many problems in the sector are really issues of ownership (who controls the entity), governance (how is the utility directed/managed; good people, right incentives = better performance; transparency reduces corruption), and resources (financial and technical skills, funding, etc.). Nothing happens without funding and know-how.

The sector cannot focus solely on regulatory reform. Other necessary initiatives that need to be solved include ownership, governance, resource problems, and the need to go “hand-in-hand” with regulatory reform. These involve ring-fencing — to separate service provision from other functions and to define regulate-able entity; performance-based contracting — to improve governance/accountability; clustering systems — to increase economies of scale, and technical and financial capacity; and financing — to align with objectives.

There is also a need to address the franchise issue -- i.e. who has the authority to grant the right to provide service in a particular area — NWRB or the LGU? Unless this issue is addressed, it will remain difficult to encourage investment to expand access or to properly finance the sector. In the interim, NWRB should seek a workable solution that protects CPC holders from arbitrary expropriation, or at least ensure adequate compensation to facilitate expansion/financing.

HIGHLIGHTS OF DISCUSSIONS

PLENARY DISCUSSIONS ON PRESENTATIONS

Regulation or Technical Support

Atty. Sofronio Larcia (Brgy. Ibabaw Residents Association Inc.) expressed his concern on whether strengthening regulation will contribute to the attainment of the MDG goals. Perhaps, what is necessary could be as simple as technical support. He further clarified that while water service providers (WSPs) are not against having a national body to oversee water service, the people they serve are already supervising them. For instance, if rates are too high, the consumers complain.

ED Ramon Alikpala (NWRB) concurred that technical support is important since it is a necessary condition in the provision of water. Having a regulator is likewise necessary to ensure the sustainability and viability of the WSPs. The provision of water is not just about laying out pipes and pumps — which will go to waste without technical supervision. If the utility is not sustainable, service will be affected. In the provision of water, there is the concern on “what is an affordable rate?” The regulator can determine and set rates that are fair, which in turn, will ensure the sustainability of the operation of the WSP.

Rationalization of Existing Regulatory Structures

Mr. Exequiel V. Gallano (San Jose Water Service Cooperative) cited that the agenda during the July pre-conference consultations was on strengthening regulation. While it has been established that different bodies regulate different water utilities, there is a need to improve the regulation and have one regulator. In addition, Ms. Rory Villaluna (STREAMS) pointed out that it is necessary to rationalize the different regulatory structures and implement common performance standards.

Information Dissemination for LGUs

Mr. Aquiles Zayco (Kabankalan Water District) remarked that NWRB should hold discussions with LGUs, considering that there are some mayors who are unaware of the existence of NWRB. There is a need for information dissemination and raising awareness. Ms. Villaluna confirmed this need.

Joint Regulation by NWRB and CDA

Mr. Salvador Arabit's (Darangan Water Service Development Cooperative) queried on the possibility of launching the joint NWRB and CDA circular on the regulation of water cooperatives in October. Atty. Nathaniel Santos (NWRB) informed that the circular is still a ‘work in progress’ but assured that there is an intention to launch in October 2008.

Consensual Regulation

Mr. Renato San Jose (Municipality of Tigaon, Camarines Sur) requested for enlightenment on the essence of a consensual relationship between NWRB and LGUs. Specifically, if it should be covered by a document. ED Alikpala agreed that there has to be a document to define the consensual relationship. This could take many forms since there are also various methods of regulation. He assured that NWRB could assist LGUs in regulating themselves. In addition, NWRB plans to go beyond the existing set-up with the five LGUs with which it has consensual regulatory arrangements. Ms. Villaluna expressed that the difficulty being encountered by LGUs in pursuing such arrangement is primarily the absence of one organization governing LGU-managed water systems — hence, the need to make concrete recommendations in this regard. Atty. Santos added that since NWRB is also a policy formulating entity, maybe it could also set standards that LGUs can adopt by way of policies.

Operation of WDs

Mr. Delfin C. Hilario (Metro Cotabato Water District) cited that from 1977 to 1992, WDs operated as either a private or a quasi-public corporation. In 1992, however, the Supreme Court ruled that WDs are government entities. Notwithstanding their nature, WDs are still considered as the best water service providers in the country. Some private water service providers may be better, but only in selected areas.

The operations of WDs are focused on expansion and adequacy of water supply, water quality, reduction of non-revenue water, and rehabilitation of watersheds to ensure sustainability. They also look into long-term viability of the business. Their water tariffs are highly regulated, which shows self-regulation and proves that much regulation has been done already. He extended an invitation to LGUs to visit and learn from WDs located near their areas. In response to Ms. Villaluna's query on who regulates WDs, Mr. Hilario informed that WDs are regulated heavily under PD 198. They also exercise self-regulation to improve their operational efficiencies. Ms. Villaluna noted that there is strong regulation from within through the Boards of WDs. This brings the need to define regulation more succinctly to fore.

Contracting Services by LGUs

Mr. Mario Quitariano (LWUA) asked whether Japan Sewage Works Agency (JWSA) competes with private consultants for contracting services required by the local governments. He said that under the existing procurement law, LWUA has to compete with private consultants before WDs or LGUs can hire them. Mr. Shu Nishi replied that JWSA could offer its services directly to local governments because it is the only agency authorized by the Japanese Government to deal with these entities. However, JWSA also contracts out services such as technical assistance to private firms.

Difficulty in Regulating Many WSPs

Mr. Manuel Yoingco (LWUA) asked clarification on Mr. Eisendrath's recommendation that regulation of 5,000 WSPs should not be done by one entity. The latter responded that the regulators he interviewed all said that they could not keep up with many WSPs. The possibility of one strong regulator may not be feasible for the Philippines. As such, it may be better to rank WSPs from biggest to smallest, and just concentrate on certain groups. Guidelines could then be set for voluntary compliance by the other groups. If there are many WSPs, it would be difficult to regulate tariff rates — hence the need to concentrate only on a few (i.e., the biggest ones which serve more consumers) as big water utilities are often profitable, and to guarantee that prices charged by the utility are high enough to ensure a sustainable level of service to all customers. Under a monopoly law, the regulator must make sure that consumers are not paying in excess of what is profitable.

About Atty. Larcia's query on a coherent regulatory environment for private water providers, Mr. Eisendrath noted that the Philippines has one of the more complicated situations he has encountered since there are different categories of service providers. There is no "one size fits all" regulation and his professional opinion is to segment the market according to different types of WSPs.

Mr. Daniel Landingin (LWUA) voiced concern on who will regulate whom. There are agencies regulating certain segments. The question is whether there should only be a single agency to regulate and whether the said agency has the capacity to regulate. He then agreed that there should be market segmentation.

Contractualization of Water Service Provision

Regarding the concept of contractualization from Mr. Eisendrath's presentation, Atty. Larcia cited that there are two aspects of such arrangement for WSPs — one is with own employees, and the other is with employees who are organized as another entity. If it is the former, LGUs doubt the feasibility and legality of contractualization. If it is the latter, it is unknown whether local governments may be allowed to create corporations and then enter into contracts with these corporations. While BOT contracts are allowed, what is questionable is spinning-off existing businesses to employees without undergoing the bidding process.

According to Governor Josephine Sato (Occidental Mindoro), LGUs already have corporate powers and can enter into contracts with corporations under the Local Government Code. However, the concept of contractualization is something new for LGUs and must be discussed with the different leagues to make it operational and successful. She noted that it is more efficient and professional to let a private company run the water supply service.

Mr. Alex Manto (Calapan Waterworks Corporation) shared that they have been contracted by the City of Tabuk to manage its water supply. As such, contractualization is already being done under a BOT scheme. Essentially, they will operate and manage the water supply and after a certain period, will turn over the assets to the city.

Mr. Eisendrath committed to share sample contracts for LGUs to look at and see how these can be updated to suit their condition.

Role of LGUs and WDs in the Provision of a Sewerage System

Mr. Del McCluskey (DAI) noted that in Japan, the Sewage Law was promulgated due to the outbreak of cholera or health risks. In this regard, he asked about the roles of LGUs and WDs in the provision of a sewerage system.

Mr. Landingin then clarified that the Clean Water Act is the enabling law for that purpose. Under PD 198, LWUA and the WDs have the mandate to go into sewerage projects and charge fees. There is a Technical Working Group preparing a National Sewage Plan but this is hampered by budgetary constraints — hence the need to request for technical assistance from the WB. Feasibility studies have been prepared for six cities with WB assistance, but the LGUs were not interested. This emphasizes the importance of financing in pushing sewerage projects.

Mr. Hilario added that the Metro Cotabato WD is one of the six WDs selected to establish a sanitation and sewage facility. However, financing is really the problem. He stressed the need for a strong partnership between WDs, LGUs, and LWUA. He recommended the establishment of a sanitation and sewerage board.

Ms. Villaluna then informed the group that there was a Sanitation Summit held in July 2008. The consensus reached in the summit is that LGUs have the mandate to provide basic sanitation and sewerage services, while WDs and WSPs should collaborate with LGUs and assist them to make this happen. She cited the example of the Dumaguete WD, which signed a contract with the LGU where the latter constructs the system, and the WD collects the fees. This shows that less expensive solutions to address wastewater and sewerage problems can be pursued.

Ms. Joy Jochico (USAID) queried if regulation is a driver to expand coverage for sanitation —in particular, on what will drive increases in sewerage and sanitation services. Mr. Eisendrath cited that Mr. Nishi gave a good example of how a national law that sets standards, technical regulation, cost-sharing, and incentives by national government can be effective. OECD studies

show that there is no country that pays for sanitation costs. In the US, grant money lent to the states or a loan model at subsidized interest rates were set up. Economic regulation will not be enough because it is only for cost recovery — technical regulation is still needed. She further shared that there is a law that provides for technical regulation and that there must be subsidy (financial support) from the national government.

BUZZ GROUPS ON UNDERSTANDING ECONOMIC REGULATION



Buzz groups discussing the concept of economic regulation.

The following responses were gathered from the participants when asked about their understanding of economic regulation and what it entails (the more detailed responses are found in Annex 9):

1. It is needed to balance the financial viability (i.e., attractive ROI) of an undertaking by an operator or investor against the affordability (or ability) to pay by the intended market to be served. It should aim to ensure that the poorest of the poor would be able to avail of the service.
2. It is about providing an efficient and effective manner of supervision and control of water utilities with the goal of making water and sanitation available to everyone.
3. It should take into consideration fair pricing/tariff, affordability, conservation, and protection of water resources. In addition, it must champion efficiency in operations/maintenance and the institutional viability of the service provider.
4. It involves promotion of a sustainable water system over a period of time. Every water system needs this to recover its costs and to provide investors with sufficient rates of return on their investments.
5. It concerns the long-term viability of water service tariff-setting, easy access to financing, lower borrowing interest rates, good returns on investment, good paying market, good water resource management, and good incentives.
6. It concerns the need to regulate fees to make operations affordable, and regulate profit to ensure sustainability.
7. It involves the setting of standards, water tariffs, KPIs, policies/rules to improve service/performance and to increase coverage (not only water coverage but sanitation as well).

From the responses, common terms such as tariffs, sustainability of WSPs, balancing the interest of WSPs and consumers, policies and rules, supervision and control, and standards and KPIs were noted. These confirmed the participants' common understanding of the meaning of economic regulation and what it entails. However, the question on how to bridge the gaps in economic regulation remains.

PANEL OF DISCUSSIONS

A panel comprising of ED Ramon Alikpala, NWRB; Usec. Jeremias Paul, DOF; Dir. Paisal Abutazil, DILG and Atty. Ruben Fondevilla, DOJ gave their reactions on the measures being proposed to improve regulation in the water sector.



The four panelists (L-R): Usec. Jeremias Paul, Jr., ED Ramon Alikapl, Dir. Paisal Abutazil, and Atty. Ruben Fondevilla with resource persons Mr. John Sittton and Mr. Antonio de Vera.

is a need for regulation to address the fragmented environment where policies and roles differ from one another. He added that the suggestion to develop a master plan, which is similar to what is currently being done in Malaysia, is very much appreciated. The 25- year Malaysia Master Plan for the water supply sector provides that all assets related to water belong to the national body.

ED Alikpala noted that LGUs have the responsibility to provide water for their constituents, no matter how it should be done. He agreed with the observation that there are too many WSPs without one body to regulate them. He stressed that there are too many regulating bodies at present -- while there is a lot of talk about consolidation, its success is limited because of opposition from existing regulatory structures.

However, it makes sense to amalgamate and strengthen the coordination of existing regulatory bodies. ED Alikpala added that it is in the best interest of LGUs to be regulated, although it may not be in the same manner as the other WSPs. Regulation could be done through the provision of performance standards. He then cited that after the 2007 elections, many mayors requested

A Common Goal for Various Stakeholders

ED Alikpala appreciated the honest and frank observations raised by Mr. Antonio de Vera and Mr. John Sittton in their presentations. He cited that the observations provided an objective assessment of the limitations of the NWRB and LWUA, as well as the problems in the sector. He added that there is no disagreement on the goal of achieving access to water for everyone.

Due to the absence of a central agency given the abolition of National Water System Administration (NAWASA), there

for NWRB's assistance -- that in effect, would have expanded its coverage. None of the mayors, however, knew the exact population of their municipalities that needed to be served, the basic information required to determine the necessary water service coverage.

ED Alikpala also welcomed the separation of the resource and economic regulation functions of NWRB. The presence of other agencies, particularly the Departments of Environment and Natural Resources and Health, as well as the Office of the President in the panel discussion would have helped, as there is a need to put more emphasis on sanitation and sewerage. He further emphasized the fiscal requirements critical to effective regulation and noted that fiscal independence from the national treasury is paramount to independent regulation.

Financing for Regulatory Reforms

Usec. Jeremias Paul (DOF) informed the body that the DOF could align its financing policy with regulatory reforms through the review of EO 279, particularly its concept of creditworthiness. He emphasized that financing is a means to an end. Similarly, regulation is also a means to an end. Both of these emphasize the importance of focusing on outcomes. Financing and regulation should complement each other. On the other hand, financing may be used as an incentive for WSPs to perform. This would require performance standards -- i.e., if they meet the standards, they could avail of incentives (carrot and stick approach). Without regulation or enforcement, there would be no expansion.

Usec. Paul then assured everyone that the DOF is prepared to support and advocate financing and regulatory reforms. To support the reforms, DOF is willing to provide project preparation facilities (e.g., preparation of bankable projects). The Department would also support capacity-building initiatives, particularly the provision of additional manpower and financial resources for NWRB. Moreover, the DOF is prepared to pursue financing reforms, with respect to the creditworthiness concept. He noted that WSPs could raise financing by increasing their creditworthiness, instead of relying on their balance sheets.

Usec. Paul noted that there is no legal impediment to ring-fencing LGU accounts. He stressed that regulation calls for fiscal autonomy. In other jurisdictions, it is the market which does the regulation. The DOF is supportive of providing more resources, including financing, to NWRB. However, this requires the cooperation of the Department of Budget and Management as well.

On privatization, Usec. Paul stated that at the end of the day, it is not important whether the government or the private sector runs the facilities, for as long as these are run efficiently. This emphasizes the need for regulation to recover costs and attain operational efficiency. The ability to charge appropriate tariffs would facilitate effective service delivery.

Corporatization of LGU-run Systems

Dir. Paisal Abutazil (DILG) shared that ring-fencing and the corporatization of local government operated water services are being encouraged, consistent with the major policies instituted by DILG Secretary Ronaldo Puno of exercising the dual functions of LGUs -- i.e., governance and corporate power. Much has already been done in the exercise of governmental power, hence there is need to focus efforts on the corporate powers of LGUs. He added that the DILG, through the assistance of ADB, would issue guidelines on how LGUs can effectively exercise their corporate powers. LGUs need to corporatize their managed systems, including water and sanitation utilities to de-politicize their operations. If the facilities are operated by another entity, the burden on mayors to appoint supporters to manage them will be removed.

Considering that privatization is a very controversial issue -- especially among small cooperatives as this connotes the entry of big and external private companies -- Dir. Abutazil conceded that

privatization is easier said than done. He assured the body that prior to issuing the abovementioned guidelines, the scheme will be studied very carefully to ensure that the mechanics are appropriately set. In response to a reaction from the floor about “privatization” being pushed by DILG, Dir. Abutazil clarified that what he meant was “public-private partnership.”

Full Time Service of NWRB Board Members

Atty. Ruben Fondevilla (DOJ) noted that the NWRB Board Members do not serve on a full-time basis. To enhance the effectiveness of the Board, its members should serve full-time, as these will improve their appreciation of the water sector. While the need for an independent economic regulator is well recognized, NWRB must have substantial budget in order to function effectively and efficiently. Currently, NWRB has a very small budget and perhaps there is a need to amend the law -- i.e., the Water Code. Another option is to reorganize NWRB for the purpose of attaining fiscal autonomy and thus, provide better services to its clients.

Public Service Orientation of Water Districts

Mr. Arnulfo Villania (Metro Tuguegarao Water District) stressed that the best concept to adopt is the water district concept. While WDs are government-controlled corporations, they are not profit-oriented -- instead, they are public service oriented. They are not concerned with Return on Investment and satisfying political interests. Most local executives, however, do not understand the autonomous nature and provisions of Presidential Decree 198. LWUA can help WDs push their real mission of serving their constituencies, but it is more concerned with the collection of loan payments. Meanwhile, EO 279 clearly specifies that LGUs have the responsibility to ensure that WDs under their area of responsibility are viable. He stressed that there is a need to revisit the EO to achieve its real objective.

Delineation of Functions and Resources

Gov. Josephine Sato (Occidental Mindoro) expressed that while it is basically true, there is no need to generalize that local government officials are more concerned with satisfying their political interests. After all, regulation is a very sensitive issue, especially for LGUs. The discussions have convinced her that there should be a single and independent regulatory board. Moreover, there should also be delineation of functions and resources among the stakeholders to serve their constituents better. She cited that most LGUs are not confident in exercising their corporate functions. It is a welcome development that the DILG has realized the need to educate local government officials on their corporate purposes. It is important, however, to involve and consult local officials before issuing any memo circular.

Dir. Abutazil concurred with Gov. Sato that all policies and issuances affecting the LGUs should be done in consultation with local officials. He assured that major consultations, in coordination with the Leagues of Provinces, Cities and Municipalities, will be done before the DILG guidelines are issued.

Partnership between LGUs and WDs

Engr. Marcelo Sumampong (Maragusan Waterworks and Sanitation MPC) reiterated the importance of WDs. He shared that the Maragusan WD has a partnership with the LGU in providing water to the communities in the area. The collaboration both ensured the adequacy of supply and the optimal use of resources. Regarding the presentation of Mr. de Vera, he agreed that there should be focus on water, considering that it is a basic fundamental right. He suggested that there must be a Water Commission to look into the problems of the Philippine water sector and oversee its development -- similar to the other sectors such as energy (Energy Regulatory Commission) and professionals (Professional Regulatory Commission).

Small Group Discussions

The participants were divided into four heterogeneous groups to give them opportunity to express and share their thoughts on the presentations, particularly on the proposed medium and long-term measures (see Box A).

In particular, they were asked to:

1. Comment or react on proposed institutional measures
2. Suggest other institutional reforms
3. Identify priority actions for the next 12 months
4. Discuss and comment on the long-term recommendation to create a single regulatory body

The results of the discussions were as follows:

Comments/Suggestions on the Regulatory Roles of Concerned Entities

Role of NWRB

1. The scope of NWRB's provision of regulatory guidance to the sector has to be defined.
2. Transition measures should be carefully balanced to make the arrangements more workable by utilizing existing capacities rather than "making NWRB unrealistically powerful"
3. Transition of NWRB role to full regulation of WDs should consider the option of LWUA reviewing tariffs and NWRB approving them. However, an MOU between LWUA and NWRB for the purpose is not enough. It would require additional manpower and budget. Moreover, a change in law would be necessary to make this happen.
4. NWRB's regulation of private utilities is, at times, at the expense of some WDs
5. Strengthen regulation for all private utilities and apply LHR for other small-scale water providers
6. During transition to NWRB's full regulation, there can be a MOA between NWRB and CDA for joint regulation in the interim.

Role of LWUA

1. Provide technical assistance services to all WSPs, including the LGUs
2. Regulate government WSPs
3. Continue specialized lending services to WDs

BOX A: PROPOSED INSTITUTIONAL REFORMS

Medium Term Measures:

Role of NWRB

- Provide regulatory guidance to the sector
- Act as an appellate body -- provide alternative dispute resolution mechanism
- Continue to be the economic regulator for private utilities
- Transition to full regulation of WDs, with support from LWUA in the review WD tariffs
- Regulate LGUs on consensual arrangement
- Institute benchmarking and set performance standards

Role of LWUA

- Focus on being a specialized lending institution and provider of technical services

Role of LGUs

- Ensure the provision of water supply and sanitation in their respective jurisdictions
- Ring-fence their water-operations and enter into performance contracts for service delivery
- Adopt NWRB performance standards
- Provincial LGUs to institutionalize benchmarking of WSPs
- Role of Provincial & Municipal LGUs in regulating WSPs

Long-Term Measure:

- Establishment of a single economic regulatory body

Role of LGUs

1. Regulate WSPs following NWRB regulation of private water utilities
2. Ensure the provision of WSS in their respective jurisdictions through their incorporation in the provincial master plans
3. Pursue ring-fencing
4. Service provision should not just be through performance contracts but also through other schemes.

Other institutional reforms/activities

1. Include briefing on ring-fencing and benchmarking in the DILG's Local Chief Executives Induction Program
2. Prepare a timetable for rolling out the benchmarking study
3. Flesh out more clearly the proposed medium term roles of NWRB, LWUA and LGUs
4. Recognize/study authorities of current regulators
5. Increase capacity on monitoring performance
6. Provide NG subsidy for water/sanitation services
7. Include operational guidelines on CPCs (same with CCCs)
8. Exercise PD 198 provision that all funds for water be coursed through LWUA
9. Increase capitalization of LWUA
10. Clarify implications of EO 738
11. Clarify franchise area regulation and monitoring to ensure that there is no duplication of lines as well as avoid poaching on others' lines and service areas. Others could be gap-fillers for as long as source is sustainable

Top Priority Actions (within the next 12 months)

1. NWRB and LWUA to discuss, coordinate, and delineate roles and responsibilities with DILG and DOF. Clarify conflicting roles and agree based on capacity
2. Harmonize tariff-setting methodology and regulation approaches
3. Institutionalize benchmarking and set performance standards
4. Review/harmonize various performance standards/KPIs
5. NWRB to come up with guidelines and performance standards covering all WSPs
6. Establish performance contracts between LWUA and operational WDs to meet standards
7. Set service coverage target as a condition to granting financial assistance to WDs
8. Strengthen NWRB enforcement and monitoring functions, especially monitoring on duplication of lines and illegal wells
9. LWUA to facilitate mutual cooperation with other WSPs
10. Ring-fencing of LGU accounts
11. Advocacy to LGUs on the ring-fencing concept
12. Make available capacity-building resources for LGUs for ring-fencing, etc.
13. Strengthen information dissemination to ensure that intended recipients are reached
14. Adopt Light-Handed Regulation for small-scale WSPs
15. Concerted effort to come up with real figures/statistics on "coverage"
16. Implement the Roadmap and create sub-committee on WSS under the NEDA INFRACOM
17. Formulate/update Provincial and Municipal Master Plans to include WSS concerns
18. Prepare legislation for independent regulatory body
19. Review proposed bills (on establishment of Department of Water, WRAP and WRC)

Comments on the Establishment of the an Economic Regulatory Body in the Long-Term

There was a consensus on the need to establish a single economic regulatory body. Such would require review and amendment of existing related laws. However, there must be ample consultations with WSPs in drafting the bill for the purpose. The functions of the proposed body

should include economic regulation of source development, ensuring expansion of service coverage to unserved areas, and enforcement. It should not be too bureaucratic.

The requirements for the move include the following:

1. Consensus-building among stakeholders
2. Clarification of the prerequisites (e.g., reduction in number of regulated entities because amalgamation is difficult, clarification of definitions of "access", "affordability", "sustainability", etc.) because these are not within the statistics gathered; and
3. Establishment of incentive/penalty system within the regulatory framework.

PLENARY DISCUSSION ON WORKSHOP RECOMMENDATIONS AND ACTION PLANNING

Drafting of a Bill on a Single Economic Regulatory Body

It was agreed that Mr. De Vera would review and consolidate all the proposed fiats (including the bill authored by Congressman Ignacio Arroyo creating a Department of Water and an EO signed by the Presidential Assistant on Water) and incorporate the inputs from the conference to come up with a draft bill on the envisioned economic regulatory entity. The draft bill will be subjected to further consultations among concerned stakeholders before submission to Congress. There was a concern that other groups who are not part of the conference may also push EOs or draft bills, highlighting the need for a concerted effort in pushing for a common water regulatory reform agenda.

Advocacy on Ring-Fencing

The assistance of the leagues of local government units will be tapped to advocate ring-fencing. The LPP assured that they would take it up in their next Board meeting. The LCP has already conducted its General Assembly, but will circulate a memo to its members to get their reactions. Since there was no representative from the LMP, the assistance of DILG was sought.

Proposals on the Strengthening of NWRB

Atty. Santos informed the group that the NWRB is still working on the proposals for technical assistance to be submitted to the ADB, which was agreed upon during the July pre-conference consultations. One TA proposal is on the establishment of economic regulatory guidelines, customer service code, and tariff regulation. There will be another proposal on sewerage.

The NWRB also clarified that the deputized authority granted to cooperatives is still valid. Regarding the Light-Handed Regulation, it is expected that the NWRB-CDA agreement will come out in October.

On the capacity-building of NWRB, particularly its need for manpower, it was emphasized that consultations with DBM would be necessary.

Other Concerns

The creation of a water sub-committee under the NEDA INFRACOM to help push and monitor the action points was reiterated. Meanwhile, the need to improve the database on coverage was also raised to facilitate regulation and monitoring.

REMARKS BY SELECTED PARTICIPANTS

Gov. Sato pointed out that the more important thing now is how to traverse the Roadmap. She emphasized the following key words: review, clarify, delineate, integrate, harmonize, institutionalize, and standardize. Likewise, she underscored the need to get *"our acts together and gear ourselves toward the creation of an independent economic regulatory body."* There is room for more enlightened local government executives (LCEs). The LCEs recognize their limitations and that they can be effective only up to a certain point. Hence, they agree to be regulated by an independent regulatory body. Gov. Sato further committed that the League of Provinces in the Philippines (LPP) will pass a Board Resolution to express support for the creation of an independent regulatory body and ask the President to certify the bill creating the said body as urgent. She suggested that there should be a simultaneous filing of bills in Congress and the Senate. The DILG was requested to require all LGUs to prioritize water and sanitation services in their annual development plans and to conduct orientation seminars for newly-elected LG officials on topics such as ring-fencing. Gov. Sato ended by saying that politics should not be viewed as a setback but more as a challenge.

Mayor Roseanne Marie I. Paylaga (Panaon, Misamis Occidental) stressed the importance of regulation, even if it is only self-regulation. She cited that after the July pre-conferences, self-regulation was instituted in her municipality, resulting in the doubling of the collection of fees of the local water system. This proves that regulation is indeed needed to improve the performance of WSPs. The need for LWUA and NWRB to "become friends" and get their acts together to provide guidelines and standards to steer LGUs in the right direction was also stressed. Considering the efforts exerted by everyone concerned, Mayor Paylaga stated that she looks forward to assessing the status of the agreed action plan after a few months.

Mr. Daniel Landingin, Deputy Administrator of LWUA, assured the group that he generally agrees with the recommendations presented. He noted that LGUs need to be informed on whom to approach for their requirements. He cited that resolutions on LGU-run systems are sent to the Office of the President and forwarded to LWUA, but the latter could not act on them because they extend assistance to WDs only. More often than not, these requests are endorsed to other agencies. Under EO 279, LGUs could establish WDs and will be provided with a three (3) month operating fund. There are currently 15 pending papers/applications for the voluntary formation of WDs with LWUA. Meanwhile, he informed that LWUA could provide technical assistance even if the LGU does not want to put up a WD. He further stressed that forming a WD solves problems like ring-fencing. Regarding the filing of a bill, he stressed that the need for financing should be included in the draft bill.

CONSENSUS AND NEXT STEPS

After the presentations by the four groups of their respective outputs and the discussions that ensued, the participants agreed on measures to be undertaken within the medium term (in the next 12 months) and over the long-term. Notwithstanding, it was stressed that the path would not be easy since there are still a number of hurdles or gaps that need to be overcome and/or addressed.

Group presentations revealed a general consensus on the need for the proposed institutional measures. The following roles were confirmed:

1. NWRB to continue to be the economic regulator for private utilities; provide guidance to the sector especially on institutionalization of benchmarking and setting of performance standards; and regulate LGUs on consensual arrangements. Issues regarding NWRB as an appellate body were raised in view of its conflicting role as an approving body for water tariffs. NWRB and LWUA will coordinate to discuss transition mechanisms to full regulation of WDs by the NWRB and review of tariffs per EO 123.
2. LWUA to be provider of technical assistance to all water service providers especially to the LGUs
3. LGUs to be responsible for the provision of water supply and sanitation in their respective jurisdictions; work on the ring-fencing of their water-operations; adopt national performance standards; and adopt benchmarking of WSPs.

Medium Term

The following measures require immediate attention inasmuch as they need to be done in the next 12 months to pave the way for an effective and efficient regulation of the water sector:

1. Harmonization of the regulatory roles of LWUA and NWRB
2. Institutionalization of benchmarking
 - LWUA, NWRB, DILG & DOF to set the key performance indicators
3. Dissemination of contractualization of service delivery with either public or privately owned utilities as an option of LGUs or WDs to improve utility performance
4. Advocacy on water supply and sanitation concerns and need for regulation
 - Advocacy with the LCEs within the next 6 months; LPP to elevate WSS concerns to the President and support regulatory reform measures
5. Capacity building for LGUs on
 - a. Ring-fencing
 - b. Benchmarking
 - c. Provincial master planning
 - d. Others (corporatization of water utilities, contractualization and joint ventures for WSS projects)
6. Finalization of guidelines on light-handed regulation
7. Review of proposed EOs and other legislations towards an independent regulatory body to be led by the Road Map Committee/TWGs
 - Conduct of consultations among stakeholders
 - a. Forum involving proponents of related EOs & other legislations
 - b. Conduct of forum in October with legislators and selected WSPs
 - Harmonization of existing bills on water regulations and proposal to set up apex body
 - Drafting of a consolidated bill within 6 months
 - Profiling of congressional & house committees to be involved thru PLCPD

- Push for sponsorship & deliberation of consolidated bill in the House & Senate
 - Advocate with existing Congress through the appropriate congressional/senate committees.
8. Establishment of a database on water supply and sanitation coverage by level of services nationwide
 9. Formulation/updating of provincial water supply, sewerage and sanitation sector plans
 10. Setting up of the Water Sub-committee under NEDA InfraCom to oversee the implementation of the medium-term action agenda
 11. Follow up with DBM on the request for additional NWRB budget

Long-term

In the long term, the establishment of a single, economic regulatory body with the following functions will be pursued:

- a. Issue licenses
- b. Formulate tariff principles/approve tariffs
- c. Set licensee targets/performance standards
- d. Monitor and enforce compliance

Next Steps

The conference laid out the reform agenda, a roadmap to improve and expand water service coverage. To traverse this roadmap and produce results, time, resources and commitment of stakeholders are required.

The conveners of this conference are expected to shepherd the implementation of this agenda. The reform agenda will be discussed with the principals of the NWRB Board. It will also be included in the agenda for discussion in the next meeting of the NEDA Infrastructure Committee. In particular, the recommendation to have a single regulatory body will be discussed with Secretary Ralph Recto of NEDA, who has expressed interest to push the issues in the water sector.

An assessment of the status of implementation of the reform agenda is imperative in the next months to come.

ANNEXES

ANNEX 1: PROGRAM OF ACTIVITIES

Tuesday, August 5

- 11:00** **Registration of Participants**
- 12:00** **LUNCH**
- 1:00** **Welcome Address**
Arjun Thapan, Director General for Southeast Asia Department
Asian Development Bank
- Keynote Address**
Ramon Alikpala, Executive Director
National Water Resources Board
- 1:45** **Acknowledgment of Participants**
Facilitators: Rory Villaluna, STREAMS, Conference Facilitator
- 2:00** **Introductions, Conference Objectives and Agenda**
Del McCluskey, Conference Facilitator
- 2:10** **Overview of the Water Sector and the WSS Roadmap**
Ruben Reinoso, Jr., Assistant Director General
National Economic Development Authority
- Session Objective: Provide an overview of the current state of water supply and sanitation services, challenges and opportunities and the roadmap that will guide policy and institutional reforms for improving water supply and sanitation services.
- 2:30** **Synthesis of the 3-Day Consultations with the Water Utilities**
Atty. Nathaniel Santos, Deputy Executive Director
National Water Resources Board
- Session Objective: Provide a summary of the findings and recommendations that emerged from the recent consultations that NWRB led with water districts, LGU-managed water utilities and privately operated water systems.
- 2:50** **Open Forum/Questions and Answers**
Del McCluskey
Rory Villaluna
- 3:20** **COFFEE BREAK**
- 3:50** **International Experience in Water Utility Regulatory Reform**
Allen Eisendrath, Energy Team Leader, Office of Infrastructure
& Engineering
USAID
- Session Objective: Provide participants with international lessons learned and best practices in water sector regulation and reform. The presentation will focus

on approaches adopted in other countries including the use of operating contracts and the use of incentives to improve water service performance.

4:10 Japanese Experience in Delivering Improved Sanitation Services

Shu Nishi, Vice Director, Planning Design Division
Japan Sewage Works Agency

Session Objective: This session will describe how Japan regulates water and sanitation service providers.

4:30 Open Forum, Questions and Answers

Del McCluskey
Rory Villaluna

Wednesday, August 6

8:00 COFFEE

8:30 Recap of Day 1 Activities and Agenda for Day 2

Del McCluskey

8:45 Advantages of Regulation and Proposed Measures

Antonio de Vera, Consultant, GTZ

Session Objectives: The presentation will focus on the advantages of regulations on Philippine water utilities and proposals for medium and long-term regulatory and utility reform measures

9:15 Reactions on Regulatory Reform Measures for Philippine Water Utilities

John Sitton, Technical Director for Public Services
Emerging Markets Group

Session Objectives: The presentation will examine the current state of water utility regulation in the Philippines, discuss proposed measures for improving regulation and present how regulation fits within the broader framework of efforts to improve water and sanitation services.

9:35 Open Forum, Questions and Answers

Del McCluskey
Rory Villaluna

9:45 Panel Discussion

Undersecretary Jeremias Paul, Dept. of Finance
Director Abutazil Paisal, Dept. of Interior and Local Government
ED Ramon Alikpala – Facilitator

The panel will give their reactions to the examination of the current state of water utility regulation and the measures being proposed to improve regulation.

10:25 Open Forum, Questions and Answers

Del McCluskey

Rory Villaluna

- 10:35** **COFFEE BREAK**
- 10:45** **Workshop Agenda and Mechanics**
Rory Villaluna
- 11:00** **Workshop Session: Recommendations to Improve Water Supply and Sanitation Coverage and Performance**
- 12:30** **LUNCH**
- 1:30** **Group Presentations**
Del McCluskey
- 2:00** **Plenary Discussion on Workshop Recommendations and Action Planning**
Rory Villaluna
- 4:00** **COFFEE BREAK**
- 4:30** **Remarks by Selected Participants**
- 4:45** **Conclusions and Next Steps**
Ramon Alikpala, Executive Director
National Water Resources Board

ANNEX 2: MESSAGES

MESSAGE

Mr. ARJUN THAPAN

Director General for Southeast Asia Department



an Development Bank

Mr. Arjun Thapan (2nd from left) with NWRB Exec. Dir. Ramon Alikpala, NEDA ADG Ruben Reinoso, Jr. and NWRB Dep. Exec. Dir. Nathaniel Santos

Introduction

NEDA Assistant Director General Ruben Reinoso, NWRB Executive Director Ramon 'Dondi' Alikpala, ladies and gentlemen, distinguished guests -- good afternoon and welcome to ADB Headquarters.

To most of you, I should actually say, "welcome back". Just a month ago, many of us met during pre-conference seminars to lay the groundwork for the discussions and decisions that will unfold today and tomorrow. On behalf of ADB and our partners from GTZ, JBIC, USAID, and WSP, we want to express our gratitude for the time and energy you have devoted to this entire endeavor. We are also grateful for the new participants joining us today and look forward to your contributions.

Regulation for Change

To summarize this conference program, it is about change. To be more exact, it is about deliberate change. We are here to solidify our commitment to regulatory reform of the sector by formulating an agenda that will put us on the critical path to positive change. Change that should be manifested in more efficient services, expanded coverage, a future of more Filipinos with access to safe drinking water and sanitation services, whether they live in fringe urban communities or remote rural villages.

Change has the potential to make anybody or any institution or organization a little uncomfortable, no matter how positive the change might be or how much we know we need it. And you-- as technical and governance professionals in the water sector-- know how necessary change is in your operations. After all, you put change on the agenda, earlier this year when you accomplished-- under the leadership of the Department of Finance and NEDA-- the Philippines Water Supply and Sanitation Sector Roadmap.

The Roadmap identifies the current regulatory environment in the Philippines as a major roadblock to greater coverage. Regulation, you said, should be a priority area for capacity development initiatives. Inherently, regulation is all about change-- changing the way we manage our human resources, our financial structures, and our operational approaches. We will hear more about the Roadmap this afternoon from Benny Reinoso.

Upon review of this important work, we were pleased and yet still curious, if you will. On one hand, the Roadmap is an insightful stocktaking of your capacities and where the gaps need filled. It is a thorough needs analysis of current financial and operational management systems. It is certainly an articulation of your commitment to capacity development. On the other hand, the link between capacity development and system expansion is less clear.

We have often heard it said that the challenge of expanding coverage to difficult areas and improving the quality of services overall is not an issue of financing but of capacity. This is true. Without sufficient technical, operational, and political capacity, further expansion of systems will fail. But I would like to remind us all that capacity alone will not fix the state of our infrastructure. Eventually, this too must be addressed.

Investments do also have an important place on the change agenda.

The Capacity Expansion Equation

The roadmap between capacity development and system expansion is pretty straightforward, yet difficult to navigate no less. It goes something like this. Establishment of performance standards. Increased regulation of those standards. Operators meeting those standards register change in efficiency, higher revenue, sustainability. Operators enjoy higher creditworthiness and attract financing. Systems expand.

One of the most critical outcomes of more efficient urban services should be the redirection of national and local government funds to areas which are often overlooked-- the rural areas. Newly freed national resources as a result of improved urban water supply performance should be redirected in rural water supply service delivery, which requires different service principles than what can sustain urban services.

The Realities

My simple summary of the journey does not deny the realistic inputs to make it happen: the time, resources and commitment required. The development community represented here today is ready to assist you in clearing the roadblocks to increased investments and system expansion-- one of the greatest being the under-developed regulatory regime. Developing the sector's capacity to regulate is a sure route to making operators more creditworthy to attract investments for expanding systems to those who are still waiting in line. And we all know who is typically last in line to be served. They are the ones who need it most-- the poor.

During the 3-day pre-conference last month, a day was devoted to each of the three major categories of water service providers in the Philippines-- local government units, water districts

and small-scale private providers, including cooperatives and homeowners associations. We discussed with you the specific challenges you face in navigating the water service terrain:

- Local government units face the challenge of charging for water, and much more of negotiating necessary tariffs with a public that is typically dissatisfied with the services they are getting. Performance standards vis-a-vis regulation offers grounds for difficult political decisions. However, while they may appear politically difficult, the resulting good performance will no doubt be a major political achievement that could aid one's bid for re-election. The public has proven time and again to be willing to pay more for better services, but they need the confidence that the public operator will indeed deliver.
- Water districts are caught between not being entirely public nor are they private. Yet, despite being relatively autonomous, they are at risk of political interference and the inability to raise tariffs beyond the level needed to service debt. It has been pointed out that water districts, on the average, service only about 40% of their franchised jurisdiction. This clearly shows that there is regulatory weakness that needs fixing.
- Small scale private water operators are vulnerable to an insecure investment environment. They face potential capture of their systems should they become too successful, so that they must carefully balance the investment needs of an area against the ability to recover investments quickly. The reality on the ground shows though that interim as they may appear, they play a major role in filling the huge gap in service coverage.

Viable Future

Despite your diverse and sometimes interlinked challenges, a consensus was found for the way forward at the pre-conferences. For the long term, you communicated during your respective seminars that the sector should pursue a formal, national, independent regulator similar to the Philippines' Energy Regulatory Commission. For the short term, it was agreed that the role of the National Water Resources Board should be expanded to a greater regulatory role over services by major providers. Currently, five local government units have entered into consensual agreement with NWRB while several small scale water service providers and cooperatives, including homeowners associations have also registered with NWRB and are jointly working on light handed regulation.

We are here today to capitalize on that consensus and build an agenda for the future. We recognize some of your nervousness about entering the regulatory waters. And we commend you for your commitment to get there.

I wish you great success in your pursuit of new knowledge and critical decision making today.

Thank you.

MESSAGE

Mr. RAMON ALIKPALA

Executive Director

National Water Resources Board

A pleasant afternoon to all of you. We are gathered here today to address one challenge, which is how to provide water to every Filipino. Reports say that the Philippines will meet the MDG targets by 2015. In fact, the sanitation target has been surpassed two years ago. Meeting the water supply and sanitation targets are necessary preconditions to meet other MDG targets related to health, education, and poverty, among others, by 2015. It is really all about change.

The NEDA, together with NWRB and GTZ, has developed the Water Supply Sector Roadmap, which is a comprehensive plan that addresses all water sector issues, such as institutional strengthening, capacity building and alliance building. Creating an effective regulatory body is central to institutional strengthening. When NAWASA was abolished, the country lost a central body for water. Hence the sector is now fragmented. The different agencies, such as LWUA, MWSS, PEZA and NWRB have mandates that overlap as well as leave gaps.

There is a need to harmonize the myriad of agencies and realize why there is a need to do so. The group has to determine what can be done in the medium-term. For the next two days, proposals on how to address the problems will be heard from the stakeholders. There is a need to decipher a multitude of laws. Questions to be answered include how NWRB can work with LWUA and how regulation can create an environment conducive to investment.

This conference is a milestone because it brings government and donor agencies to achieve a common goal. I look forward to the group's participation and support in the next two days.

Thank you.

ANNEX 3: PRESENTATION ON OVERVIEW OF THE WATER SECTOR AND THE WSS ROADMAP

Mr. RUBEN REINOSO, JR.

Assistant Director General
National Economic and Development Authority

Strategic Collaboration for Sector Development

The Philippine Water Supply Sector
Roadmap

**National Conference on Regulatory
Reforms**

NEDA Assistant Director-General Ruben S. Reinoso, Jr.
06 August 2008

The Philippine Water Supply Sector Roadmap

- A collaborative effort among national and local government agencies/ institutions, NGOs and other stakeholders
- Led by NEDA and NWRB with support from the GTZ
- It sets the general direction for the Water Supply Sector to achieve:
 - Targets as specified in the 2004-2010 Medium Term Philippine Development Plan (MTPDP) and the 2015 Millennium Development Goals (MDGs)
 - Sustainability of water supply provision

The Philippine Water Supply Sector Roadmap

To address perennial issues in the sector:

- Institutional fragmentation
- Lack of an executive and legislative sector champion
- Inadequate Support for Rural Water Supply
- Low Tariff and Cost-Recovery Level
- Low Performance of Water Utilities
- Weak and Fragmented Regulatory Framework
- Sector Investment and Financing
- Lack of WSS Sector Information

Sector Overview

The Paradox

- 421 Major River Basins
- 119 watersheds
- 61 major lakes and streams
- Rainfall average 2,400mm annually
- 50,000 sq.km. of groundwater reservoirs with a reliable surface water supply aggregate of **833 million cubic meters (MCM) per day**



Demand Projection

↑ 124%

↑ 185%

↑ 281%



- ❖ By 2025: Metro Manila, Cebu, Davao, Baguio, Angeles, Bacolod, Iloilo, Cagayan de Oro and Zamboanga will experience critical water needs
- ❖ By 2010: Metro Manila alone will need **1.9 BCM/year** (JICA)

Access and Coverage

- **NSO (2000) - 46.13%** HH Level II & Level III
- **LWUA (2007) - 24.15%** HH Level III of Water Districts
- **DILG - 21.6%** HH Level I, Level II, & Level III

Level III	Outside NCR ¹		NCR ²		Total Coverage
	Level II	Level I	Level III	Level III	
9,062,094	657,523	7,862,652	9,932,560	9,932,560	27,514,829

¹ Based on Existing PW4SPs (Partial Level II & I figures only)

² Based on NSO 2000

Total Population (NSO 2000): 76,485,088

Coverage: 36%

Institutional Environment

30 Agencies

For Water Supply, Irrigation, Flood Control, Pollution Control, Watershed Management, Financing, Policy formulation and coordination and others

LGU agencies, LWUA & WDs, MWSS, DILG and NAPC-WASCO with DPWH

For Water Supply Development

Type of Provider	Estimated Number
Water Districts*	580
LGU Utilities	1,000
RWSAs	500
BWSAs	3,100
Cooperatives	200
Private Firms	900
Total	6,280

*As of 2003-2004, 127 were considered non-operational (WB 2005)

Financing and Investments

- PhP 6 to 7 Billion Per Year → MDG by 2015
- Underinvestment on local public utilities at PhP 400 Million/Year
- Weak investment planning
- Dependent on national government lending (i.e., LWUA) and Government Financing Institutions
- Small grants for community-driven initiatives
- Congressional allocations are selective in nature
- Private financing are concentrated in Metro Manila
- Household private investments estimated at PhP 235 Million/Year

The Philippine Water Supply Sector
Roadmap

OUR VISION

“Access to safe, adequate & sustainable water supply for all.”



ANNEX 4: PRESENTATION ON SYNTHESIS OF THE 3-DAY CONSULTATIONS WITH THE WATER UTILITIES

Atty. NATHANIEL SANTOS
Deputy Executive Director
National Water Resources Board

Synthesis of the July 1-3, 2008 Consultations

“Improving Service Performance:
Consultations on Strengthening
Regulation”

Atty. Nathaniel Santos, NWRB Deputy Exec. Director
ADB Auditorium, August 5, 2008

Convened by



Supported by



General outcomes

- Appreciation by water service providers of the need for regulation to improve performance
- Consensus that a common regulatory reform agenda should be pursued to address the following critical concerns:
 - a) unclear and overlapping roles and responsibilities of regulatory agencies;
 - b) lack of performance standards and targets to gauge efficiency and effectiveness of water service operations;

General outcomes (continuation)

- c) need for guidelines on compliance and enforcement of performance standards and targets
 - d) lack of capacity to enforce regulation and monitor compliance.
- Recognition of the need for key performance indicators to guide the provision of water services and incentives to promote good performance

Day 1 – LGU-managed water utilities

Recommendations:

- Ring-fencing of LGU accounts
- Preparation of performance standards, coverage targets and guidelines for LGUs
- Advocacy on economic regulation to local chief executives, local councils, and waterworks units
- In the long-term, establishment of the mandate/authority of national body to enforce regulation and sanctions for non-compliance



Day 1 – LGU-managed water utilities

Next steps:

- Dissemination by DILG of the results of the benchmarking exercise, particularly to those who participated in the exercise
- Conduct of benchmarking against standards
- Agreement on the KPIs and timeline/assignment of performance targets
- Dissemination of guidelines by concerned national agencies

Day 2 – Water Districts

Conclusions from the discussions:

- WDs and LWUA seemed unable to see regulation beyond PD 198.
- The reactions from WDs focused only on operational issues and no specific recommendations to improve service performance, specifically to address the 60% service coverage gap, were offered.



Day 2 – Water Districts

Conclusions from the discussions:

- Although LWUA opined that its mandate as financier, technical assistance provider and regulator is working and should remain as such, LWUA is not designed as an independent economic regulator and its tariff-setting function is more focused on ensuring that its loans are repaid.

Day 2 – Water Districts

Recommendations:

- The tariff setting guidelines of LWUA and NWRB need to be harmonized.
- There is a need to come up with benchmarks for WD performance to improve service delivery and coverage.

Day 3 – Other Providers

(Private Utilities, rural waterworks, water cooperatives)

Recommendations:

- NWRB will formulate a customer service code (CSC) or manual which will bind the agency to WSPs, in the same way that WSPs bind themselves to the households they serve through their own respective CSCs.
- Light-handed regulation is needed and could be availed of provided certain conditions are met, i.e., good standing, meeting a certain service coverage target, etc.



Day 3 – Other Providers

(Private Utilities, rural waterworks, water cooperatives)

Recommendations:

- NWRB and the Cooperatives Development Authority will meet and agree on regulatory arrangements (e.g., tariffs, depreciation reserve fund).
- Accreditation of tariff reviewers whose fees can be recovered within the tariff proposal will be pursued.
- Provisional certificates of public convenience (CPCs) can be granted based on performance.

THANK YOU!

ANNEX 5: PRESENTATION ON INTERNATIONAL EXPERIENCE IN WATER UTILITY REGULATORY REFORM

Mr. ALLEN EISENDRATH
Energy Team Leader
Office of Infrastructure & Engineering
USAID

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FROM THE AMERICAN PEOPLE

International Experience in Water Utility Regulatory Reform

Dr. Allen Eisendrath
Office of Infrastructure & Engineering, USAID/Washington



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Experience in International Water Utility Regulatory Reform

TOPICS TO BE COVERED

- Key features of successful sector water sector reform
- Prerequisites for effective regulation
- Results of the USAID "good practices" study
- Contractualization and aggregation
- Dealing with capital costs



Indonesian illegal connections



Armenian wastewater treatment plant



Egyptian water plant

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KEY FEATURES OF SUCCESSFUL REFORMS

- **Autonomy and accountability of the water utility**
- **Incentives for reform; penalties for failure**
- **Progressive performance standards**
- **Cost reflective pricing**

Our cases: Armenia, Australia, Brazil, Bulgaria, Chile, Colombia, Cote d'Ivoire, Czech Republic, Egypt, Estonia, France, Germany, Hungary, Indonesia, Jordan, Latvia, Lithuania, Malaysia, Morocco, Netherlands, Poland, Romania, Russia, Senegal, Singapore, South Africa, Spain, Sweden, Thailand, UAE, Uganda, UK, US, Ukraine, Vietnam, Zambia



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OBJECTIVES → HOW SUCCESSFUL REFORMERS ACHIEVE THESE OBJECTIVES

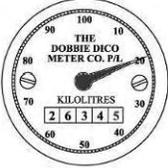
<ul style="list-style-type: none"> • Autonomy & accountability of the water utility • Incentives for reform; penalties for failure • Progressive performance standards • Cost reflective pricing 	}	<ul style="list-style-type: none"> • Complete decentralization or effective regionalization • Corporatization & corporate governance reform • An effective regulatory agency • Incentive based operating contracts • Private sector participation • Shift from capital grants to sustainable financing mechanisms
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DECENTRALIZATION IS THE MOST COMMON REFORM APPROACH. CONDITIONS FOR SUCCESSFUL DECENTRALIZATION INCLUDE:

- FULL LEGAL TRANSFER OF ASSETS, AUTHORITY & RESPONSIBILITY FOR WATER & SEWERAGE
- CLEAR, REALISTIC & PROGRESSIVE PERFORMANCE STANDARDS & AN EFFECTIVE MEANS OF ENFORCEMENT
- A MECHANISM FOR FINANCING CAPITAL INVESTMENT
- CORPORATIZATION OF SERVICE PROVIDERS
- OPERATING CONTRACTS
- A MECHANISM FOR SETTING COST-BASED TARIFFS
- A TRANSITION PLAN





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Regulators in our Best Practices in Water Utility Regulation Study

Abu Dhabi - Regulation & Supervision Bureau *

Chile - Superintendent of Sanitation Services (SISS)

Colombia - Water Regulatory Commission (CRA)

Laos - Water Supply Authority of Lao P.D.R.

Lithuania - National Control Commission for Prices *

Mozambique - Water Regulatory Council (CRA)

Senegal - SONES - Contract Regulator and State Holding Company

Ukraine - No central regulator

Zambia - National Water Supply and Sanitation Council (NWASCO)

* Multi-sector regulator

6

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EFFECTIVE REGULATION REQUIRES
A "REGULATABLE ENTITY"

A "regulatable entity" is one that is accountable for its performance, responsive to incentives, and able to make its own managerial decisions

Accountability is often established through:

- (1) corporatization;
- (2) commercialization;
- (3) licensing;
- (4) contractualization.

In most cases, accountability requires changes in law

Accountability depends on a framework & mechanisms for good corporate governance: board procedures & composition, bylaws, charter, performance plans & agreements

7

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Regulation is about incentives; Incentives & public sector ownership can be a major problem

Regulators set incentives.

Regulating public utilities is extremely difficult, because most employees don't have incentives that are meaningfully related to either short or long-term performance.

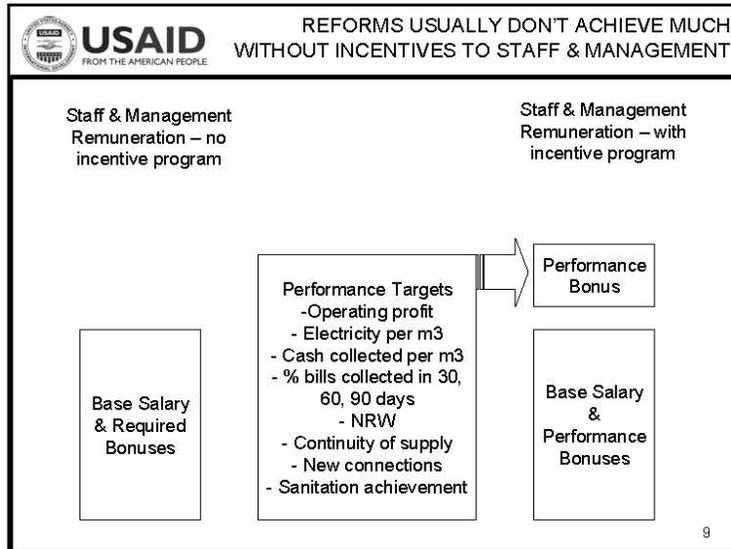
To make regulation of public companies effective, we have to:

- Find a way to provide incentives;
- Ensure adequate autonomy and accountability;
- Make targets realistic, achievable & important.

In most reforming countries, this involves:

- Corporatization & commercialization;
- Contractualization;
- Licensing





- USAID** FROM THE AMERICAN PEOPLE
- What are the key characteristics of effective regulators in our study?
- Most successful regulators have the power to enforce **ECONOMIC COST RECOVERY** set in primary law;
 - Almost all have arrangements to transition from low cost recovery to full economic cost recovery over a reasonable period of time;
 - Most use a defined procedure to establish progressive performance targets. These targets are built into rates and bonus formulas;
 - Regulators that deal with large numbers of utilities say they cannot keep up with the workload of individual rate orders. They **use benchmarking and set methods, not rates.**
- 10

 USAID FROM THE AMERICAN PEOPLE	We asked world experts how to deal with revenue shortfalls during the transitional period
<ol style="list-style-type: none">1. Regulation won't work if corporate governance doesn't work.2. There is no revenue gap in many situations IF the utility is properly governed and managed.3. A well-run utility with good corporate governance typically has low UAW, enumerates all customers, bills most water delivered, and collects most bills.4. By promoting fundamental things like increasing collection and stopping losses (theft, leakage), regulators improve the quality and reliability of service, strengthen management & close cash-flow gaps.	
11	

 USAID FROM THE AMERICAN PEOPLE	We asked world experts how to deal with revenue shortfalls during the transitional period
<ol style="list-style-type: none">5. During transition, regulators can function in an advisory role to help water utilities:<ol style="list-style-type: none">(a) prepare business plans,(b) improve business processes, including metering, billing, and collections,(c) determine asset condition,(d) develop information systems,(e) obtain financing.	
12	

 USAID <small>FROM THE AMERICAN PEOPLE</small>	How do you set improvement targets during the early stages of transition?
<ol style="list-style-type: none"> 1. A common transitional goal is to require operating income to match operating costs. 2. Establish a mechanism for resetting progressive performance targets: contractualization or benchmarking. 3. If allowed under civil service rules, regulators can function as technical auditors to authorize bonuses based on results. 4. Tariff and subsidy design can be powerful incentives for improved performance by directing financial rewards to specific outcomes that affect performance targets, monitoring, and reward/penalty systems. 	
<small>13</small>	

 USAID <small>FROM THE AMERICAN PEOPLE</small>	MANY COUNTRIES USE CONTRACTUALIZATION TO ESTABLISH INCENTIVES & SET PROGRESSIVE TARGETS
<ul style="list-style-type: none"> • Contracts range from performance agreements to lease contracts, to concessions, partial divestiture, and full divestiture. • Innovative ways are being found to “contractualize” relationships with public sector employees. • Splitting asset ownership from water business operations is common. This allows shorter contract periods, more meaningful short term performance target setting & reduces investor risk. • Types of incentives include: <ul style="list-style-type: none"> – A share of operating income or net profit; – A fixed fee per m3 billed and collected – A fixed operating margin 	
	

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EXAMPLES OF CONTRACTUALIZATION

**LATHUR TOWN (300,000 POPULATION)
MAHARASHTRA, INDIA
TRANSACTION DEVELOPED BY CRISIL INDIA**

1. Bidders propose bulk supply price for a 5 year operating contract
2. Highest bulk payment (per m3) wins the contract
3. Winning bidder operates water treatment plant, transmission, distribution for 5 years. All capex associated with customer connections & tertiary network is operator responsibility
4. Operator figures out best way to deliver, bill & collect for water

5. System transfers back to Water Board at the end of 5 years

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ANOTHER VARIATION ON THE CONTRACTING MODEL: AQUARIUS & CO., POLAND

Former employees established a private company in 1989 to operate water and wastewater services.

Piaseczno city owns all assets, but let three operating contracts: urban stormwater; urban water & wastewater; rural water & wastewater.

Aquarius won urban water & wastewater, and storm water contracts.

In 2003, all urban assets were re-competed under a ten year lease; Aquarius won.



Protesting water policies

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THE OPERATING LEASE MODEL: LODZ, POLAND

The city established two commercial law joint stock companies to operate water and wastewater services. Shares are 100% owned by the Lodz government.

Water and wastewater assets are owned by the city and leased to the operator.

Lease contracts specify annual performance targets.

City is putting assets under an Asset Holding Company to deal with tax issues and financing needs.



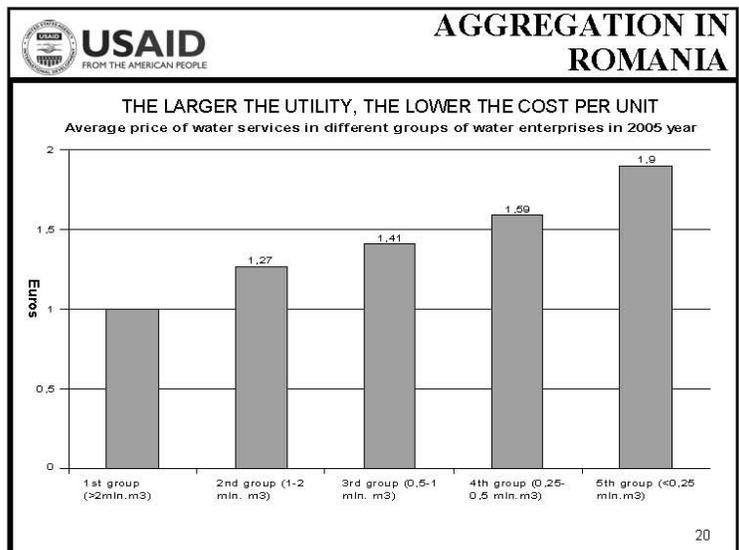
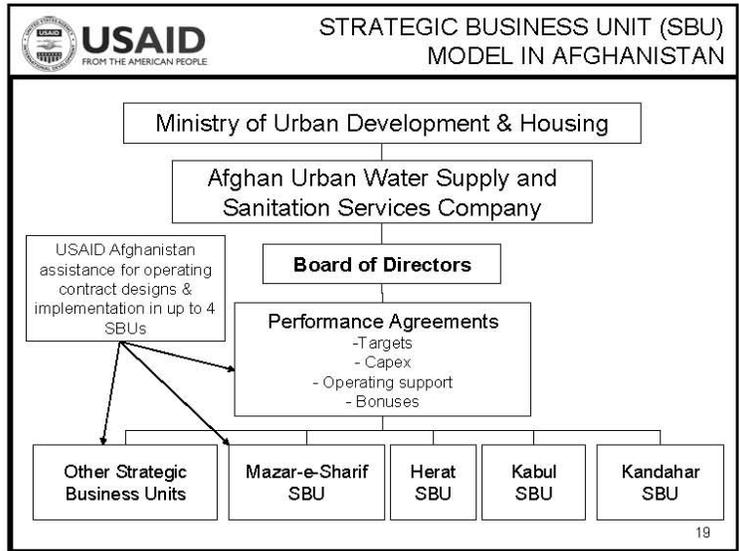
17

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Achievements of Contractualisation in Uganda NWSC

Perf. Indicator	1998	2007
Service coverage	48%	71%
Total connections	50,826	185,898
New connections per year	3,317	25,000
Staff per 1000 connections	36	7
Coll. Efficiency	60%	93%
Unaccounted water	51%	32%
Proportion metered accounts	65%	99.6%
Annual turnover	US\$11.0M	US\$ 40.0M
Profit (Loss) After. Dep	Loss: (US\$ 2.0M)	Profit: US\$ 4.0M

18





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PULLING IT ALL TOGETHER: RECOMMENDATIONS
FOR WATER REGULATION IN THE PHILIPPINES

Recommendations:

- Treat each market segment differently; don't try to regulate 5000 service providers
- Make sure that regulator has legal authority to regulate: this may require an amendment to law
- Regulate only the regulatable segments
- Encourage use of contracts, performance agreements & competition for the market

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PULLING IT ALL TOGETHER: RECOMMENDATIONS
FOR WATER REGULATION IN THE PHILIPPINES

Recommendations:

- Provide incentives for consolidation
- Use public financing instruments to require cost reflective pricing & business plans
- Force commercialization by requiring corporatization and/or contracting for communities >15,000
- Do innovative contract trials: bulk based method, short term operating contracts

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**ANNEX 6: PRESENTATION ON JAPANESE EXPERIENCE
IN DELIVERING IMPROVED SANITATION SERVICES**

Mr. SHU NISHI

Vice Director, Planning Design Division
Japan Sewage Works Agency

**Japanese Experience
on Water Sanitation**

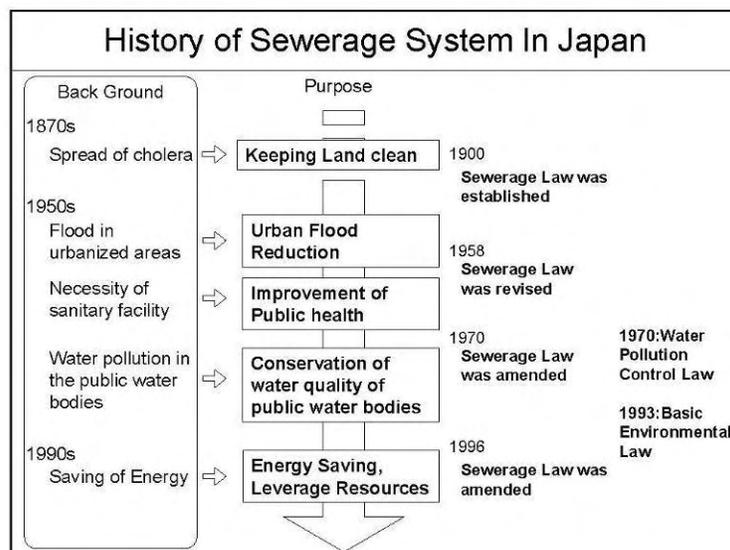
August 5, 2008

Shu Nishi

Vice-Director, Planning and Design Division,
Japan Sewage Works Agency

- 1. History of Sewerage System in Japan**
 - How to spread the sewerage system -
- 2. Development of the Legal system**
- 3. Financial Resources**
 - Construction and Management -

History of Sewerage System in Japan
- How to spread the sewerage system -



How to spread the Sewerage system in Japan?

The Issue:

- 1.Lack of Public's knowledge
- 2.Shortfall of Financial resources
- 3.Shortage of Engineer

1. Lack of Public's knowledge

- In 1870s, Spread of Cholera
- In 1950s, Water pollution in rivers and the public water bodies became prominent, and environmental pollution became a serious concern.

Necessity of sanitary facility was recognized



National Government and Municipality inform the necessity of Sewerage system through Education and Public relations

Basic of the Sanitation

- > Water Supply
- > Sewerage System
- > Cleanup the Waste

2.Shortfall of Financial resources

It is very hard to gain the profit through the sewerage works

Public responsibility for development infrastructure as National Minimum.

The Sewerage System has the great effects on the National power, because it improves the Sanitary Condition and Productive capacity.

The role of the Sewerage System is mainly to play public benefit and public purpose (Improvement of the living environment, conserve the water quality of public water body)

Incentives and Resources are necessary



National Government established a sustainable financial base by the Law

- > Subsidy System
- > Local Bond
- > Payment by beneficiary
- > Usage fee

At first, the Financial Regulations (Subsidy system and Fee Collection, etc.) were lacked in the Sewerage Law of Japan, so local governments were in financial distress and they could not construct the Sewage system.

3.Shortage of Engineer

Lack of engineers in Local government



National government make the **Technical Guidelines**

National government and Local government set up the **Japan Sewage Works Agency (JS)**

Japan Sewage Works Agency (JS)

- > Technical Support as the dispatch of Engineer
- > Construction of the Core Facilities
- > Conduct the Training
- > Technical Development, Technical assessment

Major technical guidelines Published by Japan Sewage Works Association

○**Guideline for sewerage facilities planning and design and supporting documents.**

→Process of plan making, Design procedure of facilities etc.

○ **Guideline for comprehensive plan of regional sewage improvement and supporting documents.**

- Basic policy of sewerage maintenance
- Pollution load and pollution analysis
- Calculation of estimated sewage flow
- Allocation of necessary facilities and decision of capacity etc.

○**Guideline for earthquake resistance standard of sewerage facilities and supporting documents.**

- Procedure to decide earthquake resistance standard, calculation formula.
- Procedure of checking earthquake resistance. Etc.

○**Guideline of sewerage maintenance and management**

- Create and manage ledger
- Checking, inspection, cleaning and dredging
- Rehabilitation methods
- Measures for accident etc.

Training Programs of Japan Sewage Works Agency

- JS offers training programs covering various subjects relating to sewerage; 5 courses of planning, management, detail design, construction supervision, and operation/maintenance.
- Training programs are open to foreign trainees.

Course	Subject
Sewerage Planning	Introduction to sewage works
	Sewerage master plan
Sewerage Management	Sewerage Management
	Measures for delinquent sewer rate
Detail Design	Sewers
	Sewer rehabilitation and construction supervision
	Wastewater treatment facilities
Construction Supervision	Construction Supervision
Operation and Maintenance	Measures for infiltration/inflow
	Treatment facility operation
	Introduction to water quality control
	Troubles regarding water quality control

Economical
- 2/3 of expenses are aided by national subsidy.

Local Training Available
- Local training and dispatch of instructor.

Dormitory Provided

Instruction by Experts

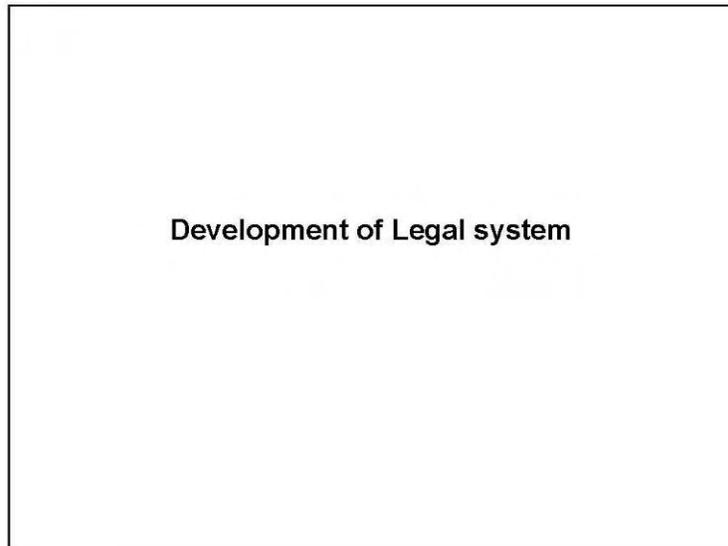
Practical Curriculums

Specific Courses Available for Qualification

Information Exchange and Presentation Capacity Building through Discussions

Covering various subjects relating to sewerage;
Planning, management, detail design, construction supervision, and operation/maintenance.

Training Center (Toda City, Saitama)



Development of Legal system



It is important to clear the following points by development of legal system.

- >To clarify the Responsibility / Role-sharing
 - National Government, Municipality, Public (Land owner, House owner)
- > To set up the regulation as Technical Criteria
- > To set up the regulation about the usage of sewage system
 - Duty of setting Drainage facilities
 - Duty of connecting to the Sewage system
 - Duty of setting Equipment for safety disposal
- >To limit the obstacle activities
- >To establish the system of Check

It is important to clear the following points by development of legal system.

- >To set up the system of the usage fee and the payment by beneficiary
- >To set up the Subsidy system, free loan and transfer of the government-owned land

Financial Resources
- Construction and Management Cost -

To construct and manage the sewerage system continuously, huge cost and long term is necessary



It is very important to establish a sustainable financial base

In Japan, Sewerage fee is not enough to cover all administration cost (construction and O&M)

For construction, National government subsidy and Local bond is necessary.

Money transferred from General account is necessary to make up the lack of sewerage fee

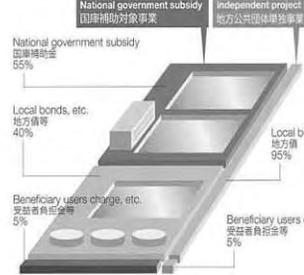
Breakdown of resources 1/2

Construction Cost of Sewerage Systems

下水道の建設費

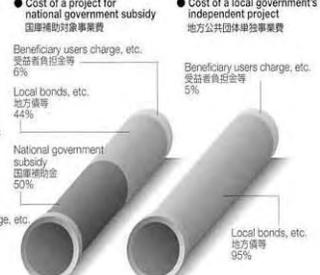
Wastewater treatment plants

下水処理場



Sewer pipes, etc.

下水道管きよ等



Breakdown of resources 2/2

Administration cost

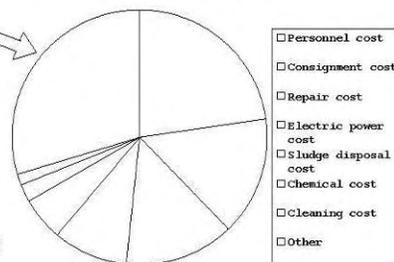
outcome

Refund of Local bonds	Management cost
-----------------------	-----------------

income

Money transferred from General account	Sewerage Fee
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Management Cost



About 70% of the Administration cost is Refund of Local bonds.

About 60% of the Administration cost is financed by the Sewerage Fee.

Subsidy System

Public responsibility for development infrastructure as National Minimum.

The Sewage System has the great effects on the National power, because it improves the Sanitary Condition and Productive capacity.

The role of the Sewage System is mainly to play public benefit and public purpose (Improvement of the living environment, conserve the water quality of public water body)



So National Government established the Subsidy system to develop and spread the sewage system.

Local Bond

Sewage works is not a business so local bond is issued by a low interest rate

Payment by beneficiary

Give back some of the asset value of land that is improved by the Sewage system

Usage Fee

Pay a cost according to the Polluter-pays principle (PPP)

ANNEX 7: PRESENTATION ON ADVANTAGES OF REGULATION AND PROPOSED MEASURES

Mr. ANTONIO DE VERA
Consultant, GTZ

Why Economic Regulation



By
Antonio de Vera
Consultant, GTZ

Why Rules?

- *Road traffic, property ownership, taxes, setting up a business, passport & visa, OCWs, medicines, marriages, bank deposits, firearm ownership, infrastructure, etc*
- Peace and order; health reasons; state security; stability and sustainability of society



Why Regulate Water Utilities?

Water utilities are natural monopolies and regulation is needed:

As a proxy for competition:

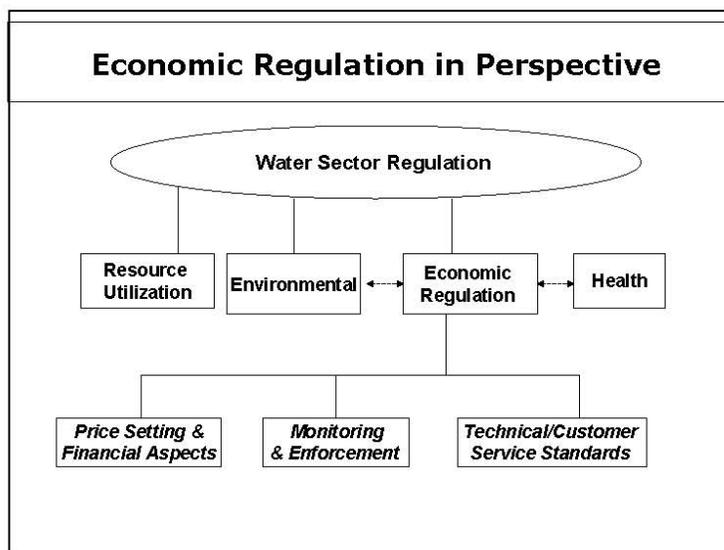
- Promote efficiency standards*
- Service improvements*
- Coverage expansion*



To address a range of market failures:

- Lack of information, pollution, resource sustainability, health and safety*

Economic Regulation in Perspective



Advantages of Economic Regulation

For Customers

- Ensures water quality and service levels*
- Protects against unreasonable prices*
- Grievance or appeal procedures*

For Community

- Adequate coverage levels*
- Service sustainability*



Advantages of Economic Regulation (con't)

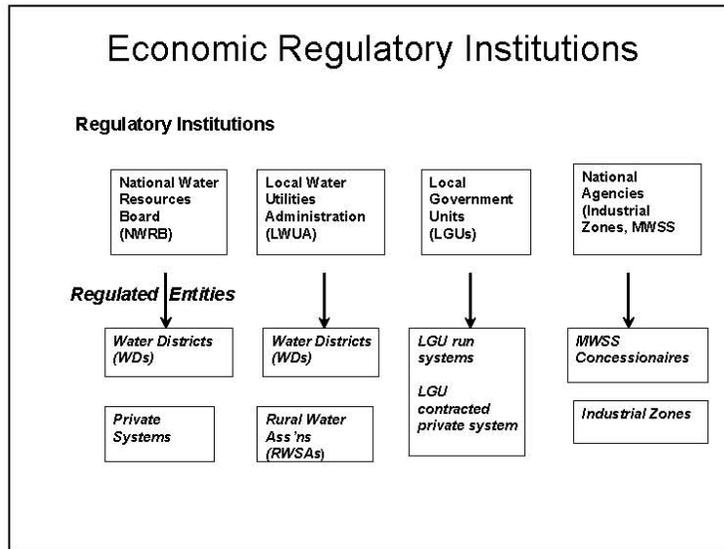
For the Utility

- Recovery of Investments*
- Incentives for utility efficiency*
- Assures operational viability*
- Relief from unwarranted interferences*

For Society

- Stability*
- Economic Development*





Tariff Methodologies

Government Agencies

- NWRB – Return on Assets
- LWUA – Cash Flow

Contract Based Regulators

- MWSS-RO – Return on Investments with Appropriate Discount Rate (ADR)
- SBWRB - Return on Equity
- CDC - Internal Rate of Return

LGUs – Cash Flow and other Considerations



Existing Regulatory Framework

Economic regulation, being done by many agencies, is fragmented with overlaps. Economic regulators do not have either resources or enforcement authority.

Difficulty of LGUs to do proper economic regulation due to their political environment, multi-functions and short term planning horizon.

Difficulty of NWRB and LWUA to do proper economic regulation.

NWRB's Constraints in Economic Regulation

- *Economic regulation is much different from resource regulation. The former generally entails financial and business management skills rather than those of resource planning and engineering. NWRB's primary mandate is resource regulation.*
- *Not given enough resources for economic regulation. Staff limitations*
- *Lack of penal provisions for violations*
- *Board members are not full time; can be changed anytime*
- *No authority to review sewerage tariffs*



LWUA's Difficulty in Economic Regulation

- *Lack of penal provisions for violations*
- *Step-in rights applicable only for loan arrears*
- *Withdrawal of CCC has no consequences*
- *Authority of LWUA over WDs w/o LWUA loans is unclear*
- *Conflicts in being a financier and regulator*



International Experience



- There is no “universal model” of a regulatory framework. The country’s wider legal, administrative and commercial arrangements that are in place have to be considered. An arrangement for a highly centralized state will be different from those where power and responsibilities are diffused to local governments.
- In all countries with water economic regulators, the water resource and health regulatory responsibilities rests with other agencies.

Recommendations

Medium Term Recommendations (Institutional Reforms)

NWRB to

- *be economic regulator for private utilities;*
- *transition to full regulation of WDs*
- *regulate LGUs on consensual arrangement*
- *institute benchmarking & set performance standards for WSPs*

LWUA to

- *focus on its role as a specialized lending institution & provider of various services*

LGUs to

- *ensure ring-fencing of LGU-run systems*
- *adopt & institutionalize benchmarking & performance standards for WSPs in their respective jurisdiction*

Medium Term Recommendations (Incentives)

Align public financing with governance, performance & regulatory reform objectives

NG to provide incentives to encourage financing to expand coverage esp. in poor communities

NG to provide incentives to encourage financing of WSPs meeting performance standards

Medium Term Recommendations (Capacity Building)



Strengthening of NWRB

*GOP approval of reorganization proposal
Dialogues with LWUA on regulatory functions
(tariff & standards)*

Formulation of light handed regulation



Strengthening LGU capacity

*Preparation of Provincial master plans
Ring fencing of LGU operated systems*

Medium Term Recommendations (Capacity Building)

Strengthening of LWUA

Amendment of EOs 279 & 421

- Review creditworthy concept
- Scrap conditions on post retirement

Review LWUA tariff methodology/benchmarking & WD categorization parameters.

Organizational Structuring

Review of lending terms/policies



Medium Term Recommendations (Capacity Building)

Strengthening of WSPs

a) Ring-fencing

b) Business planning

c) Performance standards



Long-Term Recommendation

*Formation of a single national economic regulator
with the following proposed functions:*

Issue licenses

Formulate tariff principles/approve tariffs

Set licensee targets/performance standards

Monitor and enforce compliance

ANNEX 8: PRESENTATION ON REACTIONS ON REGULATORY REFORM MEASURES FOR PHILIPPINE WATER UTILITIES

Mr. JOHN SITTON
Technical Director for Public Services
Emerging Markets Group



USAID
FROM THE AMERICAN PEOPLE



PWR
PHILIPPINE
WATER REVOLVING FUND

Reactions/ Recommendations on Regulatory Reform Measures for the Philippine Water Sector

John Sitton
Emerging Markets Group Ltd
6 August 2008



USAID
FROM THE AMERICAN PEOPLE



PWR
PHILIPPINE
WATER REVOLVING FUND

First “golden rule” of regulation

- Regulation is a means to an end
 - What ultimately matters are outcomes
- Key Philippine objectives:
 - Increasing improved water, sanitation access
 - Especially to poor communities
 - Improving operating performance
 - Moving towards cost recovery tariffs

2




Current economic regulation

- Economic regulation of the water sector is extremely fragmented and incomplete.
 - LGUs are essentially self-regulated, but don't have the resources or expertise.
 - Also, most LGUs water service providers are not ring-fenced making them impossible to regulate properly.
 - It is unclear who (i.e. LWUA or NWRB) has the responsibility to regulate water districts.
 - LWUA appears to only review tariffs for WDs that have outstanding loans; thus some WDs are not being regulated.
 - A large number of SSWPs, the gap fillers in the water sector, are not being regulated at all.

3




NWRB and LWUA

- NWRB is remarkably under-resourced.
 - It is functioning as a very “minor player” rather than as the “national” regulator for the water sector, as intended.
 - Its attention is split between water resource management and economic regulation.
 - Its funding mechanism does not provide for the level of independence or sustainability needed to perform its role.
- LWUA's dominate role is that of financier. Its focus on debt repayment discourages expansion into poorer, less lucrative areas.

4




Size and complexity of the problem

- Proper economic regulation in the Philippines is a massive undertaking, considering the
 - Geographical spread of the Philippines,
 - Number and variety of WSPs
 - Political environment.
- NWRB needs to focus on “the forest and not the trees” and on outcomes:
 - Increasing access to water, especially for the poor,
 - Improving water utility performance across the country.
- NWRB cannot be the sole regulator in the medium term

5




NWRB could quickly have an Impact

- Considering the lack of “national” guidance, NWRB could quickly have a significant impact on sector performance, including improving service coverage, if it:
 - Provided the “vision” for economic regulation in the sector;
 - Established “national” regulatory guidelines;
 - Provided “expert” assistance;
 - Monitored/measured performance of the sector, e.g. ranking WSPs;
 - Provided soft incentives, e.g. national recognition or “naming and shaming” poor performers.

6




NWRB needs focus on “effectiveness”

- Meaning, that it needs to be innovative in finding solutions to strengthening sector regulation, considering the politics, geographical spread, etc. NWRB should:
 - Focus on how best to achieve desired outcomes (find a “Filipino” solution that works)
 - Deputize (or just allow) others to provide “first-level” regulation in their jurisdictions;
 - Initially establish itself as an “expert” appellate body;
 - Train local professionals to undertake tariff reviews in accordance with the national guidelines;

7




Regulation Is a quasi-judicial function

- Fulfilling an appellate function
 - Requires experienced, independent, “judges.”
 - Following transparent, well-understood decision-making processes.
 - Producing written decisions, that document reasoning; which, to be accepted by customers and providers, must be viewed as:
 - Coherent (e.g., tariffs and service levels are linked),
 - Predictable and credible (i.e., based on precedent, rules), and
 - Legitimate (i.e., legal).



NWRB needs rapid reinforcement

- A significantly increased budget allocation
- Temporary secondment of economists, engineers from other governmental departments
- Memorandum of agreement with LWUA
 - Agree roles
 - Align objectives
 - Share costs/resources
- Donor support

9



Regulation is only part of the solution

- Many sector problems are really issues of:
 - Ownership, i.e. who controls the entity?
 - Governance, i.e., how the utility is directed/managed?
 - Good people, right incentives = better performance
 - Transparency reduces corruption
 - Resources, i.e. financial and technical skills, funding, etc.
 - Nothing happens without funding and “know how”

10



Can't just focus on regulatory reform

- Other necessary initiatives to solve: ownership, governance, resource problems, need to go “hand in hand” with regulatory reform, e.g.
 - Ring-fencing,
 - To separate service provision from other functions; to define regulate-able entity
 - Performance-based contracting,
 - To improve governance/ accountability
 - Clustering systems,
 - To increase economies of scale, technical and financial capacity
 - Financing (e.g. align with objectives).

11



Need to address “franchise” Issue

- Who has the authority to grant the right to provide service in a particular area? NWRB, LGU?
- Unless this issue is addressed it will remain difficult to encourage investment to expand access or to properly finance the sector.
- In the interim, NWRB should seek a workable solution that protects CPC holders from arbitrary expropriation, or at least ensure adequate compensation that facilitates expansion/financing.

12

ANNEX 9: DETAILED BUZZ GROUP DISCUSSIONS ON UNDERSTANDING ECONOMIC REGULATION

The responses obtained from the participants on their understanding of economic regulation were as follows:

- To balance the financial viability (i.e., attractive ROI) of an undertaking by an operator or investor against the affordability (or ability) to pay by the intended market to be served; and should aim to ensure that the poorest of the poor will be able to avail of the service of the public utility
- Ensuring that the water tariffs being charged by the water service provider is sufficient to generate the water supply at the most efficient cost given the desired return on investment
- Establishing a reasonable level of tariffs (and consequent return on investment) based on costs reasonably and effectively incurred/expended for providing a given service
- Promotion of a sustainable water system over a period of time. Every water system needs this to recover its costs and at the same time provide investors with sufficient rates of return on their investments
- Sustainability of the water utility giving ideal water tariffs that are affordable to the customers vis-à-vis customer satisfaction; and viability of the water operation for sustainable development
- Concerns the long-term viability of water service tariff-setting; easy access to financing; lower borrowing interest rates; good returns on investment; good paying market; good water resource management; good incentives
- Should take into consideration: fair pricing/tariff; affordability; conservation and protection of water resources; efficiency in operations/maintenance; institutional viability of service provider
- Standardizing tariffs to cover maintenance and operating costs
- Ensuring compliance to certain financial standards which entails a more rationalized tariff and a more sound financial position
- Establishing financially viable service provision to customers
- Protection of economic viability of individuals
- Regulation to collect fees that are not too high or excessive; should be economic cost recovery only
- Regulate fees to make operations affordable; regulate profit; standard fee to ensure sustainability
- Economic regulation is based on policy/law that allows any government agency (or agencies) to monitor, approve/disapprove certain decisions or activities of water (and sewerage) utilities with regard to pricing/tariff rates, compliance, among others
- Providing an efficient and effective manner of supervision and control of water utilities with an end in view of making water and sanitation available to everyone
- Tool/system of ensuring that regulation (economic standards) is crafted, clear and enforced in order to make it possible for a water utility to sustain its operations and provide better service by expansion of coverage and good water quality
- Policies ensuring cost-recovery, sustainability and efficient delivery and expansion of coverage of WSPs
- Set of standards to be followed in the implementation, operation and other activities of water service providers to improve water service performance

- Setting of standards, water tariffs, KPIs, policies/rules to improve service/performance and increase coverage (not only water coverage but sanitation as well)
- Control over fees/tariffs for the charges/rates to be collected by the service providers; and setting performance standards to ensure continuity of service
- Setting performance targets with reasonable tariffs
- Incentives provided to supplier of service as well as users by way of tariff structures; financial support, legal requirements
- Incentivization for efficient performance and sustainability of operations
- Providing incentives for service providers
- Balancing the interest of the water service provider and the customer; ensuring that WSPs recover costs (operating and financing costs associated with its investments) plus a fair return on investment and ensuring that the price is not so high as to decrease consumer demand; also ensuring that quality service is provided to customers
- System of putting a balance between the costs of providing goods/services with the value of the goods/services provided. It would be a way of determining the level of service the customers are willing to pay for. It is a way of ensuring the most efficient (or effective) cost in providing the goods/services being demanded.
- Balancing interests of consumers and WSPs
- A way of checking if fees are "fair" to the consumers; a way of regulating the profits of big water service providers; check and balance of profits
- Appropriate billing system for people; balancing revenue and income
- System that regulates all aspects of human consumption (i.e., food, water, air, environment, etc.)

ANNEX 10: OUTPUTS OF WORKSHOP GROUPS



Group 1 deliberating on possible medium and long term measures for regulating water utilities.

GROUP 1

Facilitators: Ellen Pascua
Fe Banluta

Documentor: Marlene Tablante

1. Hon. Josephine Ramirez-Sato, Governor, Mamburao, Occidental Mindoro
2. Hon. Cecelia B. Rebosura, Mayor, Antiquera, Bohol
3. Hon. Jose I. Ugdoracion, Jr., Mayor, Albuquerque, Bohol
4. Mr. Aguilas M. Zayco, Jr. – GM, Kabankalan Water District
5. Mr. Arnulfo C. Villania – GM, Metro Tuguegarao Water District
6. Ms. Celia M. Amurao, Bookkeeper, Sta. Lucia Water, Inc.
7. Ms. Bernardito L. De Jesus, LWUA

Comments/Reactions on the Proposed Measures

Medium Term

- Transition measures are okay but should be carefully balanced to make the arrangements more workable by utilizing existing capacities rather than “making NWRB unrealistically powerful”
- The scope of NWRB’s provision of regulatory guidance to the sector has to be defined
- NWRB’s regulation of private utilities is at times, at the expense of some WDs
- Transition of NWRB role to full regulation of WDs to consider the option of LWUA reviewing tariffs and NWRB to approve
- Make the briefing on ring fencing and benchmarking part of DILG’s Local Chief Executives induction program

Long Term

- Supports the establishment of an independent national regulatory body but requests ample consultations with WSPs in drafting the bill

GROUP 2

Facilitators: Joy Jochico
Dick Borbe

Documentor: Carla Grino

1. Hon. Roseanne Marie L. Paylaga, Mayor, Panaon, Misamis Occidental
2. Hon. George M. Minor, Mayor, Margosatubig, Zamboanga del Sur
3. Mr. Benjamin R. Ensomo – GM, Surigao Metro Water District
4. Mr. Delfin C. Hilario – GM, Metro Cotabato Water District
5. Mr. Art Estable, Asst. Vice-President, Filinvest Land, Inc.
6. Ms. Fe T. Rebanco, General Manager, Primewater Infrastructure Corporation
7. Mr. Alex Manto, General Manager, Calapan Waterworks Corporation
8. Ms. Edna G. Canlas, General Manager, Subic Water and Sewerage Co., Inc.
9. Hon. Ma. Lourdes “Marides” Fernando, Mayor, Marikina City, LCP
10. Ms. Desiree A. Barrameda, Supervising Legislative Staff Officer II, House, Committee on MDG
11. Ms. Marilou Mahinay, DILG
12. Mr. Daniel I. Landingin, LWUA
13. Ms. Petronila Conti, LWUA
14. Mr. Ludivino Geron, LBP
15. Atty. Marlon T. Molina, NWRB
16. Ms. Yolanda Gomez, STREAMS
17. Ms. Lecira Juarez, Chairperson, CDA



Group 2 agreeing on medium term measures and priority actions to be undertaken.

Comments/Reactions on the Proposed Measures

Medium Term:

- Agree to most of the recommendations
- WSPs should consider themselves as partners in water services
- Recognition of authority of current regulators
- Increase capacity to monitor performance
- LWUA to provide TA to LGUs
- NG subsidy for water/sanitation services
- CPCs to include operational guidelines (same with CCCs)
- LWUA to regulate GWSPs; NWRB regulate PWSPs with an appellate body

Top 3 Priority Actions:

- NWRB-LWUA to work together
- Clarify roles if conflicting, agree based on capacity (thru EO)
- Harmonize tariff-setting methodology and regulation approaches
 - Review/harmonize various performance standards/KPIs Review proposed bills (i.e., Dept of Water and Water Regulatory Commission)

Long Term:

- Independent economic regulator (not too bureaucratic)

GROUP 3



Facilitators: Belen Juarez
 Agnes Balota
Documentor: Vickie Asuncion

1. Mr. Gaspar D. Gonzales, Jr. -Cagayan de Oro City Water District
2. Mr. Felix Opeña - Chairman, Darasa RWSAMs.
3. Olga Arceo - DOF
4. Mr. Carlos M. Amasula, Jr. Dumaguete City Water District
5. Ms.Flerida Chan - JBIC
6. Mr. Robert Limbago - LPP
7. Mr. Mario I. Quitariano - LWUA
8. Engr. Marcelo G. Sumampong - Maragusan WSMPC
9. Hon. Rogelio A. Flores Milaor, Camarines Sur

10. Ms. Elsa Mejia - President, NAWASA
11. Hon. Reynato R. LatorreVillareal, Samar
12. Olaf Gatloderá – Phil. Water Partnership
13. Kessy Reyes - JICA
14. Pet Conti - LWUA

Comments/Reactions on the Proposed Measures

Medium Term:

Food for thought

- LWUA to again re-focus only on WDs?
- LWUA to continue review and approval of tariffs of WDs
 - NWRB as appellate body might be conflict of interest?

Top 3 Priority Actions (12 Months):

- NWRB & LWUA with DILG and DOF to discuss delineation of roles and responsibilities
 - Performance contract between LWUA and operational WDs
 - Indicators on service coverage target as condition to granting financial assistance to WDs
 - Guidelines for LGUs on performance standards and ring-fencing
- Institutionalize benchmarking and set performance standards
 - LWUA should facilitate mutual cooperation with other WSPs
- Preparation of legislation for independent regulatory body

Long Term:

- In agreement with proposal to create an independent regulatory body.
 - Economic regulation of source development
 - Regulation driven expansion to unserved areas
 - Enforcement should be one of the functions

GROUP 4



Group 4 commenting the proposed institutional measures on regulatory reform.

Facilitators: Manuel Yoingco
Joylynn Accad

Documentor: Adora Navarro

1. Mr. Artemio Baylosis – Baliwag Water District
2. Atty. Sofronio Larcia – Brgy. Ibabaw Residents' Association, Inc.
3. Mr. Salvador Arabit – Darangan Water Service Development Cooperative
4. Ms. Marivic Nocum – DILG
5. Ms. Viola Pontoni – GTZ
6. Mr. Drexel Roque – League of Cities
7. Mr. Antonio Magtibay – LWUA
8. Ms. Clyde Esguerra – MDFO
9. Mr. Armando Paredes – Metro Cebu City Water District

10. Ms. Maria Isabel S. Nofuente – NWRB
11. Mr. Manuel E. Macaraeg – Ramos Water District
12. Mr. Eddie Apuhin – Councilor of San Carlos City, Negros Occidental
13. Mr. Renato Z. San Jose – Partido Water Supply, Tigaon, Camarines Sur
14. Vilma P. Ocampo – San Jose Water Development Cooperative, Cavite
15. Exequiel Gallano – San Jose Water Development Cooperative, Cavite

Comments/Reactions on the Proposed Measures

A participant asked if regulation is really needed. Will it promote access or impede access instead? Under the regime of less regulation right now, service providers are proliferating. If we start regulating the providers, this may become a disincentive for existing providers to expand or new providers to come in. It was clarified that one purpose of the recommendation to strengthen regulation is to clarify the overlapping functions of agencies, e.g., in tariff setting functions of LWUA and NWRB. Moreover, there is a need to find a good matching of NWRB, LWUA, and LGU functions with the various types of water service providers. It was also clarified that the recommendation does not presuppose that there are already guidelines. There are none yet and performance standards are still to be set; thus, the need for strengthening regulation in this sense.

Overall, there was consensus that there is really a need for economic regulation. In some areas, tariffs are high because there are many add-on costs, but no regulator looks at these. In the long term, there should only be one body who will look at WSPs, otherwise, regulation will be difficult. Moreover, the regulator should not be a player in the market.

Medium Term:

Role of NWRB:

- Strengthen regulation for all private WSPs and implement light-handed regulation for small-scale WSPs
- MOU between LWUA and NWRB is not enough. Additional manpower and budget are needed. Change in law is also needed.

Role of LWUA:

- Continue specialized lending services for WDs
 - It was also asked if LWUA could also lend to LGUs and cooperatives. It was also raised that it seems that LWUA is forgetting that RWSAs should also be their concern. It was clarified that under PD 198, LWUA is mandated to lend to all “water utilities” but its resources allow it to lend to WDs only for the meantime that its capitalization has not yet been increased.
- Render technical services for all WSPs
 - It was also asked if LWUA could provide technical services for free. It was clarified that LWUA provides free all in technical services for new water districts. It also provides free services for analysis at the concept development level, but charges fees for in-depth analysis. It was also clarified that MDFO offers free TA to LGUs.

Role of LGUs

- Ensure the provision of WSS in their respective jurisdictions through provincial master plans
- Ring-fencing is doable. It should not just be through performance contracts but also through other schemes

Other Institutional Reforms:

- Exercise PD 198 provision that all funds for water be coursed through LWUA
- Increase capitalization of LWUA
- Clarify implications of EO 738 transferring LWUA to DOH. At the operational level, this probably means that the DOH will be more looking closely at water quality, but this is something that it is already doing. Another probable implication is that there will be more focus on sanitation.
- Clarify franchise area regulation/ monitoring; no duplication of pipe-laying; no poaching of other’s lines/service area; but let others be gap-fillers for as long as the water source is sustainable.
- There are cases wherein some providers lay pipes parallel to the pipes of existing providers. They find it easy to sell water because what they sell is industrial water which is of lower quality. This happens because no one regulates and monitors service areas.
- MOA between NWRB & CDA for joint regulation in the interim, transition to NWRB full regulation

Priority Actions For Next 12 Months:

- NWRB to come up with guidelines and performance standards
- Strengthen NWRB enforcement and monitoring, especially monitoring of duplication of lines, illegal wells. There is an enforcement and monitoring division in NWRB but its manpower should be beefed up.
- Advocacy to LGUs about NWRB’s roles, ring-fencing concept, etc.
- Make available the capacity building resources for LGUs for ring-fencing, etc.
- Strengthen information dissemination, e.g., there are circulars being issued which do not reach intended recipients
- Adoption of light-handed regulation for small-scale WSPs
- Concerted effort to come up with real figure/statistics on “coverage”
- Implementation of roadmap and creation of sub-committee on WSS under NEDA INFRACOM.
- The NEDA representative shared that there was an agreement to create this inter-agency sub-committee during the last Phil. WSS Roadmap Committee meeting and thus this could already happen in the next few months. The purpose of the sub-committee is to monitor the implementation of the action plans in the Phil. WSS Roadmap.
- Creation of provincial and municipal master plans and priority actions

Long Term:

- Consensus: In the long term, there should only be one economic regulating body, which should be both a policy-making body and an appellate body. WSPs proliferate even without regulation, but long-term sustainability becomes a problem. Private WSPs seem to be having no problems with sustainability because they are being regulated. Thus, the need for long-term sustainability also justifies the need for full regulation.
- Clarify the prerequisite for regulation mentioned during the presentation, specifically the reduction in number of regulated entities since this amalgamation is difficult.
- Clarify the definitions of "access", "affordability", "sustainability", etc. because these are not within the statistics being gathered currently by different agencies. For example, WDs have geographic areas of concern and access is defined in terms of households and not barangays.
- Establish an incentive/penalty system within the regulatory framework

ANNEX 11: CLOSING/CONCLUSIONS AND NEXT STEPS

MESSAGE

Mr. RAMON ALIKPALA

Executive Director

National Water Resources Board

I thank everyone for participating in the conference. I especially recognize Gov. Sato, who showed her commitment by staying on and taking part in the group discussions. I am happy that the proposals during the July consultations have pushed the water and sanitation agenda of the LGUs forward.

For small water service providers, NWRB was generally seen as an institution that gives out licenses. However, over the last five years, this perception has changed. NWRB is now seen as a regulator and has helped each utility improve through customer service codes and light-handed regulation. NWRB is now closer to being the independent regulator due to working closely with the private water providers. The contributions of WDs as the most advanced form of water utility need to be recognized, which serves as an inspiration for smaller utilities.

Regulation ensures that profits are kept within acceptable limits. WDs provide standards that all water utilities should follow. In response to the statement of Mayor Paylaga, NWRB and LWUA are friends and will work closely together.

The conference has been a healthy discussion and a rich sharing of ideas which can be brought forward to the principals of the NWRB Board. The recommendation to have a single regulatory body can be brought forward to Secretary Ralph Recto of NEDA, who has expressed interest to push the issues in the water sector. Let me assure you that NWRB will work closely with LWUA, CDA and PEZA to provide water for every Filipino.

Again, thank you everyone.

ANNEX 12: LIST OF PARTICIPANTS

CONFERENCE ON
STRENGTHENING REGULATION TO IMPROVE WATER SERVICE PERFORMANCE
ASIAN DEVELOPMENT BANK, ORTIGAS CENTER, MANDALUYONG CITY
AUGUST 5-6, 2008



NAME	ORGANIZATION
LGU-run Utilities	
1. Hon. Josephine Ramirez-Sato	Province of Occidental Mindoro
2. Hon. Cecelia B. Rebosura	Municipality of Antequera, Bohol
3. Hon. Jose I. Ugdoracion, Jr.	Municipality of Albuquerque, Bohol
4. Hon. Roseanne Marie L. Paylaga	Municipality of Panaon, Misamis Occidental
5. Hon. George M. Minor	Municipality of Margosatubig, Zamboanga del Sur
6. Hon. Reynato R. Latorre	Municipality of Villareal, Samar
7. Hon. Rogelio A. Flores	Municipality of Milaor, Camarines Sur
8. Hon. Eddie Apuhin	City of San Carlos, Negros Occidental
9. Renato Z. San Jose	Municipality of Tigaon, Camarines Sur

NAME	ORGANIZATION
Water Districts	
10. Aquiles M. Zayco, Jr.	Kabankalan Water District
11. Arnulfo P. Villania	Metro Tuguegarao Water District
12. Benjamin R. Ensomo	Surigao Metro Water District
13. Delfin C. Hilario	Metro Cotabato Water District
14. Carlos B. Amasula, Jr.	Dumaguete City Water District
15. Gaspar D. Gonzales, Jr.	Cagayan de Oro City Water District
16. Artemio F. Baylosis	Baliwag Water District
17. Manuel E. Macaraeg	Ramos Water District
18. Armando H. Paredes	Metro Cebu City Water District
Other Service Providers	
19. Celia M. Amurao	Sta. Lucia Water, Inc.
20. Art Estable	Filinvest Land, Inc.
21. Fe T. Rebancos	Primewater Infrastructure Corporation
22. Alex Manto	Calapan Waterworks Corporation
23. Felix Opeña	Darasa RWSA
24. Engr. Marcelo G. Sumampong	Maragusan Waterworks & Sanitation MPC
25. Elsa Mejia	NAWASA
26. Atty. Sofronio Larcia	Brgy. Ibabaw Resident's Association Inc
27. Salvador Arabit	Darangan Water Service Development Cooperative
28. Vilma P. Ocampo	San Jose Water Service Corporation
29. Exequiel V. Gallano	San Jose Water Service Corporation
30. Vilma P. Ocampo	San Jose Water Service Development Corporation
31. Exequiel V. Gallano	San Jose Water Service Development Corporation
Utilities Regulated By Contract	
32. Edna G. Canlas	Subic Water and Sewerage Co., Inc.
33. Atty. Norma B. Cajulis	Philippine Economic Zone Authority

NAME	ORGANIZATION
NWRB Board/Road Map IASC Members/Panelists	
34. Usec. Jeremias Paul, Jr.	DOF
35. ADG Ruben Reinoso	NEDA
36. Dir. Paisal Abutazil	DILG
37. Atty. Ruben F. Fondevilla	DOJ
38. Engr. Joselito de Dios	DOH
39. Dr. Guillermo Tabios	NHRC
LGU Leagues	
40. Robert Limbago	LPP
NWRB	
41. Atty. Nathaniel Santos	NWRB
42. Ma. Isabel S. Nofuente	NWRB
LWUA	
43. Daniel I. Landingin	LWUA
44. Mario I. Quitariano	LWUA
45. Antonio B. Magtibay	LWUA
46. Bernardito L. De Jesus	LWUA
Other GOP	
47. Niel A. Santillan	CDA
48. Julio E. Casilan, Jr.	CDA
49. Exec. Dir. Helen Habulan	DOF-MDFO
50. Marilou Mahinay	DILG
51. Ezequiel Serrano	DILG
Representatives From Congress	
52. Norberto Villanueva	Senate Committee on Public Works

NAME	ORGANIZATION
Representatives From Financing Institutions	
53. Lydia Oriol	LGUGC
54. Liduvino Geron	LBP
55. Ma. Theresa Zulueta	DBP
Members of the Working Group On Econ Regulation	
56. Ramon Alikpala	NWRB
57. Belen Juarez	NWRB
58. Manuel Yoingco	LWUA
59. Petronila Conti	LWUA
60. Joy Jochico	USAID
61. Flerida Chan	JBIC
62. Leila Elvas	WSP
63. Agnes Balota	GTZ
64. Ellen Pascua	ADB
65. Lulu Baclagon	IFC
66. Clyde Esguerra	MDFO
67. Olga Arceo	DOF-CAG
68. Dick Borbe	NEDA
69. Joylynn Accad	NEDA
70. Maria Clarissa Laysa	NEDA
71. Drexel Roque	League of Cities
72. Fe Banluta	DILG
73. Marivic Nocum	DILG
74. Rory Villaluna	STREAMS
75. Alma Porciuncula	PWRFSP
76. Doreen Erfe	PWRFSP
77. Adora Navarro	PWRFSP

NAME	ORGANIZATION
Donor Agencies/Guests	
78. Kenji Kasamatsu	JICA
79. Norito Araki	Embassy of Japan
80. Bebe Montesines	U.S. Commercial Service
81. Aurelia Micko	USAID
82. Viola Pontoni	GTZ
83. Jin Wakabayashi	JBIC
84. Kessy Reyes	JICA
85. Nikki Badelles	ADB
86. Engr. Jay Tecson	USAID – ECOAsia
Resource Persons/Facilitator	
87. John Sitton	EMG
88. Allen Eisendrath	USAID
89. Antonio de Vera	GTZ
90. Shu Nishi	JSWA
91. Del McCluskey	DAI/PWRFSP
Other Participants	
92. Olaf Gotladera	PWP
93. Marie Stella Tansengco-Schapero	Independent Consultant
94. Evelyn Orda	IDP
95. Edna Balucan	IDP
Documenters	
96. Marlene Tablante	DAI/PWRFSP
97. Victoria Asuncion	DAI/PWRFSP
98. Carla Griño	DAI/PWRFSP
PWRF-SP	
99. Aida Mendoza	
100. Liza Cruz	
101. Ferdinand Asuncion	



THIS CONFERENCE WAS

CONVENED BY:



AND SUPPORTED BY:

