

**MEDITERRANEAN COMPONENT
of the EU Water Initiative
(MED EUWI)**

**Strategic Partnership on
Water for Sustainable Development**

Lead Country: Greece

MED EUWI Egypt Country Dialogue on Water

***Framework Conditions for Private Sector Participation in Water
Infrastructure in Egypt***

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The Mediterranean Component of the EU Water Initiative (MED EUWI)

The Mediterranean Component of the EU Water Initiative (MED EUWI) constitutes an integral part and one of the geographic Components of the overall EUWI. It represents a strategic partnership among all related stakeholders (national, regional and international) in the Mediterranean region, aiming at contributing to the implementation of the water-related MDGs and WSSD targets. It, thus, seeks to make significant progress in poverty eradication and health, in the enhancement of livelihoods, and in sustainable economic development in the Mediterranean and South-eastern Europe, providing a catalyst for peace and security in the region which is a vulnerable and sensitive one from both an environmental and a political view point.

MED EUWI is led by the government of Greece (Ministry for Environment, Energy and Climate Change and Ministry of Foreign Affairs). The MED EUWI Secretariat within the Global Water Partnership-Mediterranean Secretariat, provides technical support and day-by-day running. Previously, the Euro-Mediterranean Water Directors Forum under the Barcelona Process and currently the Water Expert Group under the Union for the Mediterranean, serve as institutional support for the implementation of MED EUWI, provide advice and guidance on the MED EUWI further development and implementation.

MED EUWI develops its activities through annual work programmes, supported by the participation of a variety of institutions and stakeholders.

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MED EUWI Lead Country



Hellenic Ministry for the Environment, Energy and Climate Change
Department of International Relations and EU Affairs

15, Amaliados str., 115 23 Athens, Greece

T: +30 210 64 65 762, 64 59 213

F: +30 210 64 34 470

e-mail: m.papaioannou@minenv.gr

Web: www.minenv.gr/medeuwi/



MED EUWI Secretariat



Global Water Partnership – Mediterranean (GWP-Med)

12, Kyrristou str., 10556 Athens, Greece

T: +30210-3247490, -3247267, F: +30210-3317127

E-mail: secretariat@gwpmed.org

Web: www.euwi.net

The OECD Horizontal Water Programme and the Checklist for Public Action

*In 2007, the OECD embarked on a wide-ranging horizontal programme on water aimed at analysing the financial obstacles to the provision of safe, affordable and sustainable water and sanitation services for all. The results of the work were summarised in *Managing Water for All – An OECD Perspective on Pricing and Financing* and launched at the 5th World Water Forum in Istanbul on 17 March 2009.*

As part of this work, the OECD, working with non-OECD countries and stakeholders, developed a Checklist for Public Action, providing governments with a coherent set of policy directions that address the allocation of roles, risks and responsibilities, as well as the framework conditions necessary to make the best of private sector participation. The guidance was developed building on the OECD Principles for Private Sector Participation in Infrastructure, through regional consultations in Zambia (November 2007), Philippines (March 2008) and Mexico (September 2008).

In a second phase of the OECD Horizontal Water Programme (2009-10), the OECD Checklist for Public Action was operationalised in a number of countries, including in Egypt, Russia and Lebanon.

The present document is the result of this activity in Egypt.



Organisation for Economic Cooperation and Development

Investment Division

Directorate for Financial and Enterprise Affairs

2 rue Andre Pascal

75775 Paris

E-mail: investment@oecd.org and water@oecd.org

Web: www.oecd.org/daf/investment/water and www.oecd.org/water

Framework Conditions for Private Sector Participation in Water Infrastructure in Egypt¹

This document provides an assessment of the framework conditions for private sector participation in the water and sanitation sector of Egypt, based on the OECD *Checklist for Public Action*. It builds on answers to the *Checklist*-based Questionnaire (filled in by 5 key institutions), publicly available material, communication with key stakeholders and bilateral and multilateral discussions held during two missions to Cairo jointly carried out by OECD and MED EUWI / GWP-Med in July 2009 and January 2010. It provides an overview of recent developments on private sector participation in the water and sanitation sector of Egypt and highlights three areas for consideration by the government: the institutional framework under development; the administrative capacity; and the sustainability of projects.

The recent development of a Governorate-Based National Master Plan for Water Supply and Wastewater identifying the infrastructure needs up to 2037 and the successful completion of a tender for the New Cairo wastewater treatment plant have triggered a renewed interest to discuss the potential involvement of the private sector in the development and management of water infrastructure in Egypt. In the current context of credit constraint and tighter financial conditions, private developers are however likely to be more selective, demanding higher quality, more “bankable” projects, with clearer forms of public support and risk-sharing, which increases the focus on the adequacy of framework conditions for private sector participation.

In that context, the Egyptian authorities (notably the Holding Company for Water and Wastewater) have invited the OECD and MED EUWI / GWP-Med to discuss the conditions for a successful participation of the private sector in the water sector as part of the MED EUWI Policy Dialogue on Water in Egypt. This joint undertaking builds on: i) the conclusions of the MED EUWI Dialogue regarding the elaboration of a *Sustainable Financing Strategy for the Water Supply and Sanitation Sector in the Greater Cairo area* and ii) the recently published OECD *Checklist for Public Action*² that aims to support governments’ efforts to build a shared understanding of the risks and opportunities of private sector participation (from which a questionnaire was derived – see Annex 1).

1. Recent developments on private sector participation in Egypt

In Egypt, the gap between water and sanitation coverage has grown, with access to drinking water reaching 96.6% in 2006 for Egypt overall (99.5% in Greater Cairo and 92.9% in rural areas) and access to sanitation 50.5 % (94.7% in Greater Cairo and 24.3% in rural areas).³ In addition, 27% of wastewater

¹ The document was prepared by Céline Kauffmann of the OECD Secretariat and commented by Anthi Brouma (GWP-Med) and Peter Borkey (OECD). The views expressed in this paper do not necessarily represent those of the OECD or its Member governments. Contacts: Céline Kauffmann (celine.kauffmann@oecd.org) and Anthi Brouma (anthi@gwpmed.org).

² www.oecd.org/daf/investment/water

³ According to the Central Agency for Public Mobilisation and Statistics.

collected in the Greater Cairo area is not treated and the renovation need is estimated at 50% of the existing network.⁴ This gap and related pollution concerns are prompting the Government to adopt more aggressive strategies to extend relevant infrastructure. In particular, according to the Memorandum of Information distributed to potential bidders for the 6th of October wastewater treatment plant, the government of Egypt aims to expand wastewater capacities from 60% of cities covered at present, to 100% in 2012.⁵ In that perspective, the government envisages to substantially increase its investment in the water sector, while, in parallel, seeking to scale up private sector participation in the financing, design, construction, operation and maintenance of wastewater treatment plant projects (see Table 1).

This is part of a broader long-term policy agenda adopted in 2006 by the Government of Egypt for pursuing partnerships with the private sector to increase the level of investment in the country's infrastructure. As reported by the PPP Unit⁶, the Government estimates that Egypt should allocate between 5.5 to 7% of its yearly GDP (some US\$ 13 billion) to cover its infrastructure needs (new investment and maintenance – not just in water), of which some 10-15% could be mobilized through PPPs.

Under the new impetus, the wastewater sector is leading in terms of closed PPP deals and projects in the pipeline. The project for the wastewater treatment plant of New Cairo was the first in the pipeline of projects handled by the PPP Unit to reach financial closure and is presented as a key pilot project. The contract with the winning bidder – the consortium Orasqualia composed by the Egyptian company Orascom and the Spanish company Aqualia – was signed in June 2009 and financial closure was reached in January 2010. The Government has five additional, similar projects in the pipeline for the coming 12 to 24 months and expects more in the future (see table 1). There are signs that the PPP projects, as defined in the PPP Unit pipeline, are perceived as being attractive to the private sector. This is corroborated by the significant interest raised by both the tender for the “New Cairo” (60 interested parties, 7 qualified, 5 bids) and the pre-qualification stages for the “6th of October” (10 qualified) projects.

So far, water deals are developing in the area of wastewater treatment plants under BOT type of contracts. Additional projects in the desalinisation of water are expected, notably in Hurghada, North Sinai and West Gulf of Suez (for which concept papers are under preparation by the Ministry of Housing, Utilities and Urban Development). Future developments of projects with the private sector and potential extension to the network and service provision parts of the industry will largely depend on the institutional framework – notably the legislation currently under development and the adequate building of capacity among responsible authorities – and on the financial sustainability of the proposed projects. Under current circumstances, characterized notably by low levels of cost recovery, uncertain future tariff regulation and legislative barriers, further involvement of the private sector in the provision of water services to final consumers is not envisaged and private sector appetite remains low.

⁴ See MED EUWI (2009).

⁵ Information Memorandum, 6th of October Wastewater Treatment Plant Project, Nov. 2009:
www.pppcentralunit.mof.gov.eg/NR/rdonlyres/9D5F750B-E461-4ED2-A04B-38F8D5B6B74F/0/Infomemo.pdf

⁶ Established in 2006 in the Ministry of Finance

Table 1. Private sector participation in the Egyptian drinking water and sanitation sector, as of January 2010

Projects	Type of contract	Duration	Private partners
Cairo sewerage collection and treatment	Management Contract	1992-1996	Joint-Venture Biwater (UK) / ECG (Egypt)
Suez Special Economic Zone	BOT for 2 water treatment plants and the extension of a fresh water pipeline.	2001-2002 (suspended)	SNC Lavalin (Canada)
New Cairo wastewater treatment plant	Finance, design, construct, operate, maintain (and transfer)	Contract signed in June 2009. Construction scheduled to start in Q1/2010. Transfer to NUCA after 20 years (2 of construction, 18 of operation).	Orasqualia: consortium of Orascom (Egypt) and Aqualia (Spain)
Abu Rawash wastewater treatment plant	Finance, design, construct, operate, maintain (and transfer)	Invitation for prequalification issued in Dec. 2009. Expected date of contract signature: Q3/2010. 20-year contract.	
6th of October wastewater treatment plant	Finance, design, construct, operate, maintain (and transfer)	Invitation for prequalification issued in Nov. 2009. Expected date of contract signature: Q4/2010. 20-year contract.	
Alexandria West wastewater treatment plant	Finance, design, construct, operate, maintain (and transfer)	Pre qualification Q2/2010, Expected Request for Tendering: Q1/2010, Expected Financial Closure: Q4/2010.	
Helwan wastewater treatment plant	Finance, design, construct, operate, maintain (and transfer)	Date of contract signature to be determined. 20-year contract.	
Nahia wastewater treatment plant	Finance, design, construct, operate, maintain (and transfer)	Date of contract signature to be determined. 25-year contract.	

Source: PPP Central Unit and Perard (2008).

2. The Institutional framework under development

There is strong political will in Egypt today to attract private investors in a range of infrastructure sectors, as clearly demonstrated by the establishment of a central PPP Unit within the Ministry of Finance, the rapid development of a pipeline of projects and the provision of a guarantee by the Ministry of Finance in case of non-payment by the contracting authority for the New Cairo wastewater project. The legal and institutional framework is however still under development, with the approval of the related new legislation still pending. Allocation of roles across different public actors (including the regulator) remains under discussion. Moreover, capacity in the line ministries and responsible public agencies to carry out their assignments in the new legislative framework is still developing.

The OECD Checklist for Public Action: enhancing the enabling institutional environment

As highlighted in the *Checklist*, the government has the essential responsibilities of establishing adequate policy and regulatory frameworks, institutions and contractual arrangements and overseeing their functioning (**Principles 5 & 17**). In addition, water is a segmented sector, with oversight responsibilities for resource management and service provision often split horizontally between different Ministries, and vertically across national, regional and local authorities. This may raise important capacity challenges and also generate issues of consistency across government levels. Careful allocation of roles and responsibilities is needed across different authorities, taking into account existing capacity gaps, and based on resources allocated in line with duties and distributed in a predictable way (**principle 10**), as well as building common understanding across levels of government on the objectives, means and resources for water provision (**principle 11**).

Principle 5. Enabling environment. A sound and enabling environment for infrastructure investment, which implies high standards of public and corporate governance, transparency and the rule of law, including protection of property and contractual rights, is essential to attract the participation of the private sector.

Principle 10. Empower authorities responsible for privately-operated infrastructure projects. Authorities responsible for privately-operated infrastructure projects should have the capacity to manage the commercial processes involved and to partner on an equal basis with their private sector counterparts.

Principle 11. Clear and broadly understood objectives and strategies. Strategies for private sector participation in infrastructure need to be understood, and objectives shared, throughout all levels of government and in all relevant parts of the public administration.

Principle 17. Competent, well resourced and independent regulatory bodies. Regulation of infrastructure services needs to be entrusted to specialised public authorities that are competent, well-resourced and shielded from undue influence by the parties to infrastructure contracts.

Source: OECD (2009), Private sector participation in water infrastructure, OECD Checklist for Public Action.

2.1 Organisation of the water supply and sanitation sector

Historically, the administration of water and sanitation has been highly centralised in Egypt. However, a multiplicity of authorities affiliated to the Ministry of Housing, Utilities and Urban Development (MHUUD) is involved in overseeing the municipal water supply and sanitation sector (an example of allocation of responsibilities across institutions for the Greater Cairo is given in Table 2).

Table 2. Responsibilities of the key institutions for the water sector, Greater Cairo, 2008

		MHUUD	EWRA	HCWW	GC Water Company	GC WW Company	CAPWO	NUCA	MED	MF	MWRI	MHP	MSEA
Policy	Water sector development targets	●									○	○	○
	Tariff setting ¹	○	●										
Planning	Development strategies	○		○				○	●	○	○	○	○
	5-yr development plans	○						○	●	○	○	○	○
	National Water Master Plan		○	●	○	○	○	○					
	Annual investment plan	○		○			●	○					
Budgeting	Annual budget for capital investments						○		●				
Investment	Design			○	○	○	●	○					
	Construction			○	○	○	●	○					
	One-year maintenance before hand-over			○	○	○	●						
O&M	Operation			○	●	●							
	Maintenance			○	●	●							
	Minor rehabilitation			○	●	●							
	Billing and collection			○	●	○							
Monitoring	Performance monitoring		●					○					○
	Drinking water quality standards & water and effluent quality testing											●	○
	Effluent quality standards setting										●		
	Budget monitoring									●			

Legend: ● - prime responsible institution; ○ - other key institution.

Note: 1) EWRA makes recommendations to the Minister of Housing, Utilities and Urban Development. Final approval authority rests with the Cabinet.

Source: Med-EUWI (2009).

Under MHUUD, the National Organization for Potable Water and Sanitary Drainage (NOPWASD) is responsible for the planning, design and construction of municipal drinking water purification plants; distribution systems; sewage collection systems and municipal wastewater treatment plants throughout Egypt with the exception of selected urban areas (Cairo, Alexandria and the Suez Canal cities) for which the Cairo and Alexandria Potable Water Organisation (CAPWO) is responsible. Operational and maintenance responsibilities are delegated to local agencies, structured as economic/general authorities, public/private companies, or utilities in 27 governorates and supervised by a central organisation, the General Authority for Potable Water and Sanitary Drainage (GAPWSD). The New Urban Communities Authority (NUCA) is in charge of planning new urban developments, i.e. for comprehensive physical and infrastructure planning and for managing infrastructure design and construction supervision. Upon completion, the infrastructure is transferred to the designated governorate.⁷

In 2004, in an effort to reform the organisation of the public water sector and move towards corporatisation and regulation, Presidential Decree No. 135 grouped all drinking water and sanitation entities under a single holding company, the Holding Company for Water and Wastewater (HCWW). Along with HCWW, the Egypt Water Regulatory Agency (EWRA) was created by Presidential Decree No. 136 to provide economic regulation to the sector. Although its board of directors was appointed in May 2005 and staff was hired in 2007, EWRA is only expected to start providing regulatory services upon the implementation of the new Water Law (see below). In particular, until further clarification by the new Water Law, responsibility for tariff rates' adjustment still rests with the Cabinet.

2.2 A legislative framework for private sector participation under development

The current concession laws applicable to the water and sanitation sector (Law 129/1947 and Law 61/1958) are perceived as posing important regulatory risks for investors. They notably include unilateral government rights to amend the concession and limits on profit. To circumvent the difficulties and while legislative changes were under consideration, the New Cairo wastewater treatment plant project was tendered under Law 89 (1998), the Law on Organizing Tenders and Bids for Public Procurement.

The forthcoming projects are expected to be tendered under the new Law for Regulation of Public Private Partnership (Law 67/2010, thereafter PPP Law), approved by Cabinet in early January 2010 and ratified by the People's Assembly in May 2010⁸. This Law stipulates that public utilities law, concession law and public procurement law will no longer be applicable to PPP contracts. The new PPP Law is expected to provide a "one-stop shop" for PPPs with provisions that aim to clarify:

- i) the list of sectors to be subject to PPP (more activities are expected to be included compared to the current provisions under Law 89, which limit PPP to the wastewater sector);
- ii) the responsible authorities;
- iii) the tender rules for PPPs;

⁷ *Water Governance in Middle East and North African Countries: key challenges, gaps and mechanisms*, in OECD (2010).

⁸ The law is available at: www.pppcentralunit.mof.gov.eg/pppcusite/content/legislation/legislation

iv) the form and content of PPP Contracts; and

v) the dispute resolution mechanisms including arbitration under International Chamber of Commerce rules⁹.

Box 1: Key criteria for PPP contract as defined by the draft PPP law

- The law differentiates between the operation (whereby the private sector provides the service to the administrative contractual entity) and the concession (whereby the private sector provides the service directly to end users).
- The minimum commitments of the private sector would be to finance and construct or rehabilitate a public utility project along with provision of maintenance and necessary services provided by the project.
- The duration of the contract shall vary from five years at least to thirty years at most from the date of signature.
- The entire value of the contract should not be less than one hundred million Egyptian pounds (some €12.6 million).

Source: PPP Unit: www.pppcentralunit.mof.gov.eg/pppcusite/content/legislation/legislation

A new Water Law is scheduled for presentation to parliament in November 2010 that should complement the 2004 Decree establishing EWRA to clarify functions and responsibilities of the regulatory body. In particular, it is expected that the Law will:

i) grant power of licensing to EWRA and penalties in case of non-compliance;

ii) modify the responsibility for approving tariffs (with a view to differentiate between social and economic tariffs; the responsibility for setting the former rests with the Cabinet, while responsibility for the latter is expected to be transferred to EWRA);

iii) clarify the interface with consumers; and

iv) clarify the monitoring of performance of utilities, notably through the establishment of a set of performance indicators.

In addition, while EWRA is currently directly affiliated to the Minister of Housing (which heads its governing board), there are discussions to increase its autonomy through its establishment under the Prime Minister. The Water Law has however been under drafting for the last 3 to 4 years and has still not been approved by the Cabinet.¹⁰

In line with changes in the legislative framework, new policies may affect framework conditions for private participation in the water sector, including a Water Policy Paper currently under development by MHUUD. Preliminary work undertaken to support the development of the Policy paper has identified 3

⁹ Law 120 of 2008 created a new economic (commercial) court as a specialized jurisdiction covering economic and commercial disputes. This new court is expected to accelerate consideration of business disputes, which in the past have been extremely slow to resolve, not infrequently taking several years to reach a conclusion. The new court will have jurisdiction over Capital Market Law, the Companies Law, the Investment Law and the Intellectual Property Rights Law, among others.

¹⁰ The MWRI is also contributing to the elaboration of water-related legislation, particularly with regard to the updating and implementation of the National Water Resources Plan 2017, which was completed under the MWRI's lead in 2005.

main areas for consideration: 1) level of service and provision, 2) governance of the water sector, 3) sector financing (tariffs, PPP, subsidies).

New legislation and policies in the area of local governance and regulatory reform are also under development, with unclear consequences for private sector participation in water infrastructure. The new law on local governance and a Decentralisation Action Plan under preparation aim to address water related issues. However, the PPP programme, as established so far in the water sector, is attributing the main responsibilities for developing and supervising the projects with the private sector to central government (no responsibilities have been extended to sub-sovereign entities, such as municipalities for instance).

In order to start addressing a cumbersome legislative and administrative environment, Egypt launched in 2007 the “Egyptian Regulatory Reform and Development Activity” (ERRADA) initiative. This initiative has now completed its first stage, compiling an exhaustive inventory of all legislations that affect Egyptian businesses through a decentralized effort engaging a dozen ministries and working under the guidance of an inter-sectoral Advisory Council. This initiative, now permanently housed within the Ministry of Trade and Industry, is also reviewing the inventory with government and private sector stakeholders. It is paving the way for regulatory impact assessment of regulations affecting economic activity in Egypt and will allow the Government to systematically review and modify or eliminate provisions that are not needed, that contradict other laws, or impose an unnecessary burden on business (OECD, 2010).

2.3 Empowering responsible authorities: clarifying responsibilities and building capacity

The new impetus given in 2006 by the Egyptian government to involve private partners in the development of infrastructure constitutes an important shift in the service delivery culture towards performance-based, client-focused results. Such a shift is supported by the development of a number of institutions and/or the redefinition of the responsibilities of existing bodies. The implementation of this new framework has still to be followed by an adequate transfer of human and financial resources in line with duties and responsibilities, even though several steps have already been taken to strengthen the capacity in line ministries and public agencies responsible for carrying out projects with the private sector.

In the foreseen new architecture, the line Ministries will be responsible for:

- i) screening and selecting the projects that could be undertaken as PPPs;
- ii) analysing the project’s feasibility and risk allocation;
- iii) completing the PPP Value for Money Model (for review by the PPP Central Unit and approval for the structure of the partnership by the Ministerial Committee of PPP Affairs);
- iv) implementing project tendering and procurement according to model documents while the PPP Central Unit will review procedures and documents;
- v) signing the final contract; and
- vi) monitoring the performance of the private sector.

While a new legislative and institutional framework is under development, the allocation of responsibilities for PPP projects is not fully clarified. In the case of the New Cairo wastewater treatment plant, NUCA was the contracting authority. Technical tasks to carry out the partnership are however being delegated to CAPWO. For the projects under preparation, CAPWO is likely to become the contracting authority (or MHUUD with a delegation to CAPWO).

To act as a centre of PPP expertise and capacity building across sectors and assist line ministries in analysing projects' feasibility and value for money, a PPP Central Unit was established within the Ministry of Finance in 2006. In that perspective, a number of missions were determined (see box 2), among which the development of sector-specific standard documentation. As of January 2010, standard PPP contracts and procurement documentation, as well as information memorandum were ready for the wastewater sector. A separate water and sanitation division was also established in 2009 within the Central PPP Unit to service the New Cairo contract and the additional projects in progress.

In order to strengthen the interface with line ministries, satellite PPP Units are under consideration (it is envisaged that the satellite unit for water will be established within CAPWO), but still not established. The PPP toolkit (which includes a separate section on water and will become available on the PPP Unit website) remains under development.

In addition, a project-level PPP promotion unit aimed at promoting PPP projects to the private sector within and outside the country, was established at the Ministry of Investment, but is not fully active yet.

Box 2: Missions of the PPP Central Unit

- Promote the national PPP initiative to key stakeholders (within the Government, to private sector, to the public in general),
- Identify and facilitate solutions to formal legal and institutional obstacles to the overall PPP project cycle,
- Develop PPP best practices, models, and standards for Egypt,
- Validate and develop PPP project proposals,
- Shepherd pilot procurements of PPPs,
- Build capacity in the public sector to identify, analyze, prepare, tender, contract, and monitor successful PPP transactions,
- Alert and stimulate private contractors and lenders to enter the new PPP market,
- Assist public infrastructure authorities in the selection of experienced and quality PPP transaction advisors,
- Work together with the public infrastructure authorities and the advisors to ensure quality and consistency in procedures,
- Ensure that PPP principles, rules, and Standard Operating Procedures are followed,
- Assist awarding authorities in the transparent and competitive selection of private sector partners, and Report to the Ministerial PPP Committee on the progress of the PPP Project.

Source: PPP Central Unit (2009). Update on the national programme for public private partnership. <http://pppcentralunit.mof.gov.eg>

To remediate capacity gaps in the short-term, technical assistance on specific areas has been sought through international advisory mentoring. The design of the policies and procedures of the PPP programme benefited also from technical assistance provided by consultants from the UK. The Minister of Finance signed an agreement with the International Finance Corporation to act as transaction advisors for

a minimum of five PPP transactions across different sectors (water, sanitation, schools, health, transport), as precedents for replication for an expanded programme. The PPP standard contracts are under development in cooperation with international law firms. The World Bank is providing Technical Assistance for the development of both the Project Preparation Facility and the Infrastructure Finance Facility Company (see below).

In the specific case of the New Cairo wastewater treatment plant project, the PPP Central Unit appointed a number of different advisors to assist and facilitate the signing of the Contract, including the International Finance Corporation as the Transaction Lead Adviser, Parsons Brinckerhoff as Technical Consultants and Gide Loyrette Nouel as Legal Advisors.

3. Ensuring the sustainability of projects

PPP projects may face a number of risks, including commercial risk (mainly the risk related to revenue), contractual risk, foreign exchange risk, and arbitrary political interference. The appropriate allocation of risks across partners constitutes a key element for the success of private sector participation. But simply allocating risks is not enough to ensure that the parties will effectively bear their responsibilities *ex post*. This implies that the relevant incentives and monitoring mechanisms are in place and that the partnership is sustainable in the long run when adaptation to changes can be proved.

The New Cairo wastewater treatment plant is a pilot project, which aims to test the partnership with the private sector. It involves important innovative mechanisms – such as the Performance Monitoring Committee – that can contribute to the facilitation of a partnership but need to be concretely used to prove their operational effectiveness. Its main features - including the revenue and non-payment guarantees and financing in local currency - also raise important questions regarding the scalability of the approach.

3.1 Making cooperation work over the long run

The OECD Checklist for Public Action: making the co-operation between the public and private sectors work in the public interest

Contractual arrangements with the private sector for water infrastructure are typically long-term and as such not likely to cover all aspects of the complex relationship between the private sector and the public sector. No contract can be comprehensive enough to eliminate all elements of uncertainty. The *Checklist* highlights the mechanisms that may help reduce the uncertainty that comes with long-term incomplete contracts or deal with its consequences. They include: adopting performance-based contractual arrangements (**principle 16**); information sharing (**principles 13 & 14**); and providing for clauses and mechanisms to frame the discussions on future issues as well as formal dispute resolution mechanisms (**principle 19**).

Principle 16. Output/performance based contracts. The formal agreement between authorities and private sector participants should be specified in terms of verifiable infrastructure services to be provided to the public on the basis of output or performance based specifications. It should contain provision regarding responsibilities and risk allocation in the case of unforeseen events.

Principle 13. Establish communication and consultation with private sector. To optimise the involvement of the private sector, public authorities should communicate clearly the objectives of their infrastructure policies and they should put in place mechanisms for consultations between the public and private partners regarding these objectives as well as individual projects.

Principle 14. Full disclosure of project related information. There should be full disclosure of all project-relevant information between public authorities and their private partners, including the state of pre-existing infrastructure, performance standards and penalties in the case of non-compliance. The principle of due diligence must be upheld.

Principle 19. Setting dispute resolution mechanisms. Dispute resolution mechanisms should be in place through which disputes arising at any point in the lifetime of an infrastructure project can be handled in a timely and impartial manner.

Source: OECD (2009), Private sector participation in water infrastructure, OECD Checklist for Public Action

In the case of the New Cairo project, a project Performance Monitoring Committee was established to both ensure the adequacy of the product / service provided to the required level and to provide a mediation mechanism in case of dispute. More generally, the authorities are supporting the shift towards an output-based results culture by introducing performance indicators in the water utility sector. Information from water utilities was first collected in the summer of 2009, with the objective of making it an Annual Information Return exercise. Important uncertainty however remains as regards the reliability of the underlying information used for monitoring, the allocation of monitoring responsibilities and the capacity of the responsible bodies to perform their duties.

The insertion in the contract for New Cairo of re-equilibrium clauses, i.e. the possibility for the private party to request a re-examination of the sewerage charges in case of increase in the costs or decrease in the revenue due to events foreseen by the contract, has been seen by the private partner as an important step towards mutual accountability. The contract also foresees compensation in case of force majeure, change in law and early termination of the contract. Reciprocally, the contract contains a performance bond provision in case the private sector fails to fulfil its obligations.

A three-step dispute resolution mechanism is foreseen by the New Cairo contract that involves the project Performance Monitoring Committee, a mechanism comprising of three members – one from the private partner, one from the tendering authority and an independent expert chosen by common agreement -, and a Partnership Committee. In the eventuality that the dispute cannot be resolved amicably and within the two Committees, the third step foresees reference to arbitration under the UNCITRAL rules. Additional mechanisms are foreseen in the New Cairo contract that introduce flexibility and favour amicable resolution of potential issues, for instance a mechanism to adjust the cost of debt.

3.2 Ensuring financial sustainability

The OECD Checklist for Public Action: Deciding on private provision of infrastructure services

Financial sustainability of projects is a key focus of the *Checklist* and involves that projects bring value for money - assessed through a cost-benefit analysis (**principle 1**) -, are sustainable (**principle 2**) and affordable for the government (**principle 4**) on the long-run.

Principle 1. Informed and calculated choice. The choice by public authorities between public and private provision should be based on cost-benefit analysis taking into account all alternative modes of delivery, the full system of infrastructure provision, and the projected financial and non-financial costs and benefits over the project lifecycle.

Principle 2. Financial sustainability of infrastructure projects. No infrastructure project, regardless of the degree of private involvement, should be embarked upon without assessing the degree to which its costs can be recovered from end-users and, in case of shortfalls, what other sources of finance can be mobilised.

Principle 4. Preserve fiscal discipline and transparency. Fiscal discipline and transparency must be safeguarded, and the potential public finance implications of sharing responsibilities for infrastructure with the private sector fully understood.

Source: OECD (2009), Private sector participation in water infrastructure, OECD Checklist for Public Action

A second determinant of long-term viability of projects is their financial sustainability. This in turn depends on costs' profile for the parties to the project, expected revenues and the availability of financing. One of the main objectives set by the PPP Central Unit is to determine a realistic pipeline of viable PPP projects. This is usually done based on a market assessment and the identification of investment needs. Market assessments have been carried out by the PPP Central Unit, which combined with the recently launched Governorate-based National Master Plan for Water Supply and Wastewater, could inform an analysis of where to potentially involve the private sector (in addition to the projects already highlighted in the pipeline of projects as identified by the PPP Unit).

In addition, PPP projects raise issues of long-term affordability for the government as they may generate contingent liabilities on budget (through the provision of sovereign guarantees for example) and may commit the government to the provision of subsidies over the long run. These issues are of particular relevance in the case of Egypt, where the government is seeking the interest of the private sector to a range of infrastructure sectors (not only water). The Ministry of Finance is looking to engage in some EGP 15 billion (some EUR 2 billion) PPP projects across all infrastructure sectors between 2010 and 2015, among which approximately 4 billion (EUR 540 million) in the water sector. If all projects are provided with revenue and non-payment guarantees – as in the case of the New Cairo project -, this might generate important potential liabilities on budget and jeopardise the credibility of the guarantees provided by the Ministry of Finance.

On the revenue side, problems of low levels of cost-recovery may impede further involvement of the private partners in the water sector, either directly by limiting the interest of business to engage in activities with low cash-flows or indirectly by jeopardising the financial capacity of public authorities. In Egypt, tariffs do not recover costs (frequently not even operational costs) and their adjustment constitutes a very sensitive issue. Recent analysis for Greater Cairo¹¹ shows that the total financing gap for the water and sanitation sector amounts to EGP 169.2 billion (EUR 23.6 billion) over 20 years and is expected to increase by almost 45% in the period 2006-2026, owing to:

- User charges that do not nearly cover operation and maintenance costs in any of the two sub-sectors (water and sanitation). They account for only 11 % of the total available finance. The state budget accounts for as much as 83 %.
- A serious backlog of investment into the rehabilitation of existing infrastructure in water supply.
- Significant need for further investment to maintain coverage and service levels at current levels in a context of rapid demographic growth.

User charges play a minor role for two reasons. Bill collection rates are low (at about 50%, mainly due to lack of payment discipline in the public sector), even though they have increased in recent years from even lower levels. User charges are also low compared to international benchmarks. In Greater Cairo, domestic user charges amount to 0.04 USD/m³ (for a 10 m³ consumption), which compares to 1.65 USD/m³ in Istanbul (2007) for instance. On average user charges represent less than 1% of household expenditure, well below the frequently used affordability limit of 4 %.

The revenue risk may be further compounded by foreign-exchange risk, when the private partner seeks financing through the international financial markets. In Egypt, availability of funding in local currency

¹¹ Med-EUWI (2009)

with adequate tenor (10 to 20 years) is limited. If the private consortium involved in the New Cairo project was able to access local funding, future investors will likely have to borrow on international financial markets and therefore face foreign exchange risk. This may generate a strong constraint on the expected development of several PPP projects. Stimulating the domestic banking sector to offer longer tenors and competitive pricing is another long-term objective pursued by the Government.

Meanwhile, these elements constitute important commercial risks for the private sector and contribute to the need for credit-enhancement mechanisms. An Infrastructure Financing Fund Company (IFFC) is under development, with the support of the World Bank, to develop a local currency financial facility in order to enable project developers to hedge against exchange rate and convertibility risks. IFFC will be established as a commercially oriented financial institution operating under the capital market regulations. It will raise funds from the domestic and ultimately from the international capital market and will benefit from umbrella guarantees provided by the Government. It is expected that IFFC shareholders will include main domestic banks, national pension corporations and relevant international institutional investors.

4. Going forward

PPPs may constitute a useful tool in the hands of the Egyptian government to complement other sources of financing (such as soft loans), as it is not likely that public money alone – be it from internal resources or externally provided – reaches the level required to cover the important upfront investment needs as identified in the National Master Plan. Current limits on capacity to handle the development of PPPs and on availability of local financing, however, constitute important impediments to the development of PPP projects in the short run and are likely to slow the pace of projects' development expected by the government.

As such, Egypt may want to give careful consideration to the completion of the legislative and regulatory framework that underpins the capacity of the country to reap the expected benefits of private sector participation. The assessment has shown a particular need for:

- Clarifying allocation of roles and responsibilities across government levels and public agencies, in particular as regards oversight of private sector performance and contract compliance.
- Strengthening the capacity of dedicated public agencies. In that perspective, useful lessons can be learnt from the experience of other countries that have set up PPP units to ensure that the necessary competencies are available and clustered within the government.¹²
- Careful identification and selection of projects for PPP, based on identified investment needs (as reflected in the Governorate-Based National Master Plan for Water Supply and Wastewater), a thorough assessment of the market, due consideration to value-for-money and affordability for the government.

¹² See, for instance, documents from the 2nd annual OECD symposium on public-private partnerships of March 2009: www.oecd.org/document/32/0,3343,en_2649_34119_42324512_1_1_1_1,00.html

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ANNEXES

Annex 1 – Questionnaire based on the *Checklist for Public Action*

Annex 2 – OECD – MED EUWI/GWP-Med joint-mission summary report (Cairo 10-13 January 2010)

Annex 1 - Private Sector Participation in Water Infrastructure.

Questionnaire based on the *Checklist for Public Action*

To facilitate a better understanding of the risks and opportunities associated with private participation in the water and sanitation sector (WSS) and help governments improve the quality of their private sector participation (PSP) framework, the OECD has developed a *Checklist for Public Action*¹³. The *Checklist* provides a coherent set of policy directions in 5 policy areas: (i) the nature and modalities of private sector participation; (ii) the elements of a sound institutional and regulatory environment; (iii) ensuring public and institutional support; (iv) making the co-operation between the public and private sectors work in the public interest; and (v) the elements of a responsible business conduct. The following questionnaire was designed, based on the *Checklist for Public Action*, to help countries carry out a broad assessment of their PSP framework and identify the challenges that policy makers may face in their cooperation with private partners.

Note to respondents: please provide answers where applicable to your country and relevant to your field and indicate “not applicable” otherwise.

1 - Informed and calculated choice

- 1.1- What are the objectives for involving the private sector in WSS in your country? What are the expected benefits from PSP in WSS?
- 1.2 - What methodologies are in use or are considered to assess the sustainability of the cooperation with the private sector and determine the value for money brought by the project?
- 1.3 – How is private sector participation integrated into (made consistent with) the overall WSS services provision chain and in overall sector development?

2 - Financial sustainability of PSP projects in infrastructure

- 2.1- Has the market for PSP projects in WSS been assessed (demand and affordability constraints)? Have the long-term sources of revenues for maintenance of fixed assets in the WSS sector been evaluated and ensured?
- 2.2 - Do you consider the possibility that private partner may suggest alternative technical solutions/options or they are pre-determined?

3 - Apply tailor-made model of private sector involvement

- 3.1 – What activities, responsibilities and risks do you consider shifting to the private sector? To which expected effects? Based on what contractual arrangements/forms of PSP?
- 3.2 – Have assessments been carried out and adequate steps taken to ensure that the parties to the cooperation have the capacity to fulfil their roles and bear their responsibilities as defined by the chosen model of PSP (mandate, resources)? If not, what steps are being taken to this effect?

4 - Preserve fiscal discipline and transparency

¹³ To access the Checklist, see www.oecd.org/daf/investment/water

4.1 – Has there been any assessment of the implications of private sector participation for public finance, including in terms of subsidies, guarantees, transaction costs?

4.2 – What mechanisms are in place or under consideration to ensure fiscal discipline and transparency?

5 - Enabling environment

5.1 - What steps has the government taken or are under consideration to ensure that the laws and regulations dealing with PSP and their implementation and enforcement are clear, transparent, readily accessible and conducive to beneficial cooperation in the public interest?

5.2 – Are the different roles and responsibilities of government bodies and public authorities with regard to PSP in WSS clearly defined and understood across levels of government?

6 - Fight against corruption

6.1 - What is being done or planned to address corruption in the water sector, more specifically in the cooperation with the private sector? Is corruption addressed specifically in the cooperation framework? If not, how is it addressed? Is there information disclosure on cases of corruption? What are the mechanisms in place or envisaged to increase the probability of detection? What is the penalty associated with detection?

6.2 – Are communication and training envisaged on issues of corruption across levels of government and public agencies?

7 - Create a competitive environment

7.1 - To what extent, and how, are limited direct competition in the water sector and anti-competitive practices by incumbent enterprises addressed? Under which responsible authority?

7.2 - Have market exclusivity clauses, established to attract investors, been assessed against their potential negative impacts?

8 - Facilitate access to financial market

8.1 – Is there any restriction in access to local capital and credit markets and/or to international capital movements? Do local water operators, have access to (a) local and (b) international capital and credit markets? On which terms (concessional or commercial? What are the average and maximal size of loan, duration, grace and interest rate)?

8.2 – Is the country particularly prone to shocks that could impact on the cooperation with the private sector (e.g. exchange rate risk, high dependence on export or remittances, or on foreign capital inflow and external borrowings etc.)?

9 - Consultation with stakeholders

9.1 – How do responsible authorities ensure adequate consultation with the different stakeholders? What consultation mechanisms have been put in place with local communities and user associations? How are employees and their representatives being involved in discussions?

10 - Empower authorities responsible for privately-operated WSS infrastructure projects.

10.1 – What level(s) of government has the responsibility for coordinating and overseeing private sector activity in WSS? Are responsibilities clearly defined across responsible authorities? Are there overlaps of responsibilities or loopholes?

10.2 - Are human and financial resources of responsible authorities in line with their duties? Is there any mechanism to facilitate training of responsible authorities?

10.3 – Are performance of responsible authorities regularly monitored?

11 - Clear and broadly understood objectives and strategies

11.1 – How are objectives and policies regarding PSP in the WSS sector developed and communicated to responsible authorities?

11.2 – How is consistency of the water projects with other development programs ensured?

12 - Mechanisms for cross-jurisdictional co-operation

12.1 – Provided that water infrastructure projects may involve different jurisdictions, how is coordination ensured (across territorial entities, between central and sub-national levels of government)?

13 - Establish communication and consultation with private sector

13.1 – How are government water-related policies and objectives communicated to the private sector? How are potential changes in policies communicated / discussed with private partners?

13.2 – How is the dialogue with the private sector organised on specific water projects? Under which responsible authority? Does it involve regular meetings? Specify the areas open for discussion?

14 - Full disclosure of project related information

14.1 – Is information on the state of water infrastructure available? Are there regular inventories / monitoring of water assets? What is the agency responsible for collecting information and maintaining a database on WSS? What is done to address information gaps, specifically in the cooperation with the private partner?

14.2 – Is the due diligence process of projects given time and capacity?

15 - Fair, non-discriminatory and transparent awarding of contracts

15.1 - How are fairness, transparency and non-discrimination guaranteed in contract award?

15.2 - What criteria for selection are most often used?

16 - Output/performance based contracts

16.1 – Are contractual arrangements specified in terms of verifiable infrastructure services to be provided to the public?

16.2 – How are performance monitored over time? Is the assessment performed against a list of key indicators? Has the methodology for computing the indicators been agreed among parties? What is the timeline for the monitoring? What is the responsible authority? How is consumers' satisfaction and dissatisfaction taken into account when assessing performance?

17 - Competent, well resourced and independent regulatory bodies

17.1 – Have the regulatory bodies been established prior to involving the private sector? Is their development under consideration?

17.2 – Are their roles and responsibilities clearly defined and differentiated from one another (with no loopholes)? Do they have a clear focus and rules for decision making? What is the process for information disclosure? Are there recourse mechanisms and review processes?

18 - Allowing for good faith, transparent and non-discriminatory renegotiations

18.1 – Are contractual arrangements defined to avoid unnecessary renegotiations?

18.2 – Is the framework for renegotiation clearly specified in contract (discussion process, areas for renegotiation, time frame, costs)?

19 - Setting dispute resolution mechanisms

19.1 – Is the system of contract enforcement effective and widely accessible to private partners? Are all parties to the contract aware of the dispute resolution mechanisms at their disposal?

19.2 - What alternative systems of dispute settlement has the government established to ensure swift and preferably amicable dispute settlement at a reasonable cost?

Principle 20 - Responsible business conduct

20.1 - How does the government make clear to the private sector the distinction between its own roles and responsibilities and those ascribed to its partners? What steps does the government take to promote communication on expected responsible business conduct?

21 - Good faith and commitment

21.1 – Has Government clearly communicated its expectations to private partners in terms of objectives of PSP, capacity building, diffusion of technology, information disclosure?

22 - Fight against corruption

22.1 – How are companies encouraged to promote integrity internally to their staff and throughout the supply chain?

22.2 – How is government promoting increased transparency around transactions?

23 - Communication with the consumers

23.1 – How are companies associated in consultation processes with the users?

23.2 – How are companies encouraged to be responsive to clients' claims and establish effective procedures to address consumer complaints.

24 - Awareness and responsibility for the social consequences of actions

24.1 – What is done to promote business contribution to the assessment of social and environmental impacts of their activities?

24.2 – How are companies made aware and urged to implement internationally agreed standards and good practices?

Thank you for your answers.

Annex 2 - OECD – MED EUWI/GWP-Med joint-mission summary report

(Cairo 10-13 January 2010)

Objective of the mission

To share, discuss and enhance the draft assessment of Egypt's framework for private participation in the water sector based on the OECD *Checklist for Public Action*.

Mission progress

The mission was conducted through bilateral meetings with Mohammed El Alfy (Assistant Minister for Housing Utilities and Urban Development and Head of EWRA), Abdelkawi Khalifa (Chairman of the Holding Company for Water and Wastewater), Rania Zayed (Director of the PPP Unit), Maha Serag El Din Kamel, Senior Economist, and Ibrahim Harak, Senior Investment Specialist, PPP (Ministry of Investment), Tarek Morad (Deputy Head in the Dutch Cooperation Agency and co-chairman of the Donors' Assistance Sub-Group on Water and Environment) and Maxence Mirabeau (General Manager of Orasqualia).

In addition, an informal meeting was hosted by the Holding Company for Water and Wastewater, which brought together Mamdouh Raslan (HCWW), Maxence Mirabeau (GM of Orasqualia), Andres Merino Artalejo (Aqualia Concesiones), Sobhy Abdel Kader (EWRA), Bassel Shoirah (PPP Unit), Daniel Weiss (EC Delegation in Cairo), Peter Börkey and Céline Kauffmann (OECD) and Anthi Brouma (MED EUWI/GWP-Med).

Main findings and discussion points

Interlocutors agreed with the main issues highlighted in the assessment, in particular they acknowledged the uncertainties that investors face due to a pending legislative framework, the difficulties of aligning capacity with new duties in responsible authorities and the demonstration nature of the newly concluded BOT contract for the New Cairo wastewater treatment plant. They also confirmed the strong interest of the Government of Egypt in applying the PPP model to a range of infrastructure sectors. The mission helped to clarify the following points:

- There is strong political will to involve the private sector in BOT contracts in the wastewater sector, in a context of envisaged reduced fiscal allocation to the water sector. Upon ratification of the new PPP law, private sector participation will also be considered in the development of desalination plants. Under current circumstances characterized notably by low levels of cost recovery, uncertain future tariff regulation and legislative barriers, interest for further involvement of the private sector in the provision of water services to final consumers remains limited.
- The PPP legislation under development is likely to be ratified by June 2010. However, the Water Law that will define the responsibilities of the EWRA and, more broadly, the sector governance has no clear ratification perspective. It is therefore likely that forthcoming PPP projects will be developed before the regulatory framework is fully operational.

- Future steps to strengthen administrative capacity to deal with PPPs involve the development of satellite PPP units in line ministries. For water, this is likely to be established within CAPWO (responsible for the planning, design and construction of water infrastructure in Cairo and Alexandria).
- Despite a number of weaknesses in the current institutional and regulatory set-up, the PPP projects as defined in the PPP Unit pipeline are perceived as being very attractive to the private sector. This is corroborated by the significant interest raised by both the tender for “New Cairo” (60 interested parties, 7 qualified, 5 bids) and the pre-qualification stages for the “6th of October” (10 qualified) and the “Abu Rawash” wastewater treatment plants deals. The “New Cairo” contract limits private sector risk in a variety of ways, ie by reducing the revenue risk, by providing a guarantee in case of non-payment, and by establishing a three stage dispute resolution mechanism that favors mediation.
- The New Cairo wastewater treatment plant is a demonstration project. It involves important innovative mechanisms – such as the Performance Monitoring Committee – that can contribute to facilitate the partnership but need to be concretely used to prove their operational effectiveness.
- The scaling up of the PPP programme in the water sector is likely to face important financing constraints. The Ministry of Finance is looking to engage in some EGP 15bn PPP projects across all infrastructure sectors between 2010 and 2015, among which approximately 4bn in the water sector. If all projects are provided with non-payment guarantees, this might generate important potential liabilities and tamper with fiscal discipline. In addition, the availability of funding in local currency with adequate tenor (10 to 20 years) is limited. Future investors will likely have to borrow on international financial markets and therefore face foreign exchange risk.

Next steps

A revised version of the *Checklist*-based assessment will be circulated by early March 2010 for a final discussion with the relevant Egyptian authorities and stakeholders (PPP Unit, MHUUD, Ministry of Investment, EWRA, CAPWO, Orasqualia).

A forward-looking short document (2-3 pages) will be drafted, building on the *Checklist*-based assessment of the current PPP framework for water in Egypt, and sent to the MHUUD to contribute as an input to the Water Policy Paper currently under preparation.